1986

The Ontario Economy: Performance and Prospects

Ministry of Treasury and Economics
Office of Economic Policy
November 1986

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Ontario Economic Outlook at a Glance

	1985	1986	1987
Real Growth (%)	4.7	4.1	3.6
Inflation (%)	4.0	4.0	3.5
Job Creation (000s)	159	156	114
Unemployment Rate (%)	8.0	7.0	6.7

In 1987, Ontario's labour force will grow to over five million people and the gross provincial product will exceed $200 billion.

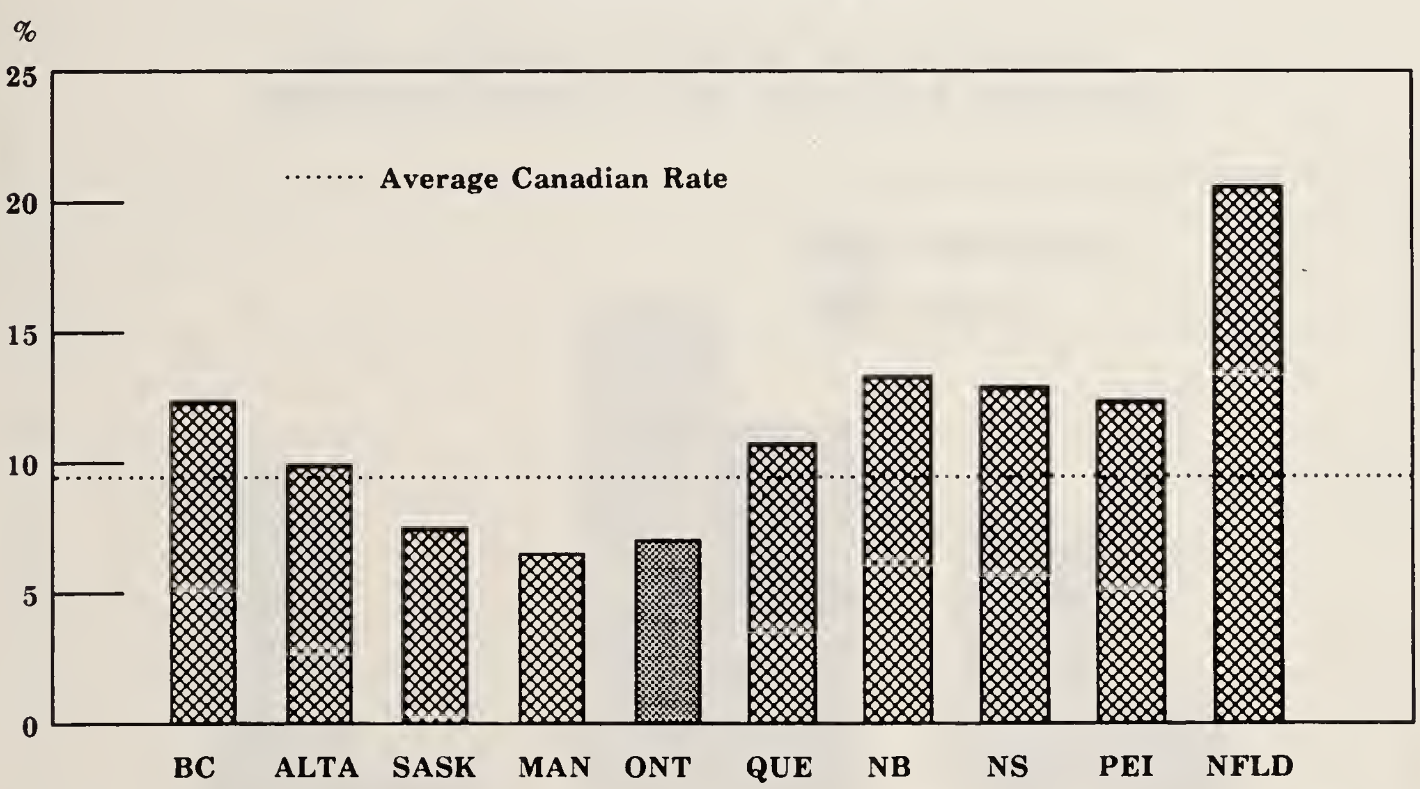
Recent Performance

The Ontario economy is now in its fourth consecutive year of growth following the 1981-1982 recession. That recession was brought on by a dramatic increase in real interest rates and the severe downturn in the U.S. economy. Consumer demand, especially for durable goods such as automobiles, dropped sharply, while businesses curtailed investment activity. The result was the deepest recession since the Great Depression of the 1930s.

Vigorous U.S. growth in 1983 and 1984 provided the initial engine for an export-led recovery. Ontario exports grew by about 38 per cent from 1982 to 1984, in large part due to higher automotive trade with the United States. In 1985, although U.S. economic growth slowed, Ontario's economy registered a third year of robust growth. The Ontario expansion became more broadly based, with domestic consumption and investment providing a greater contribution to overall economic growth.

Ontario's economy suffered more severely than other jurisdictions in the 1981-82 recession. Real output in Ontario declined, from the pre-recession peak to the trough, by 7.2 per cent compared to 6.6 per cent for Canada as a whole and 3.4 per cent for the United States. Equally significant is the fact that the recovery was particularly strong in Ontario. Throughout the expansion, Ontario's economy has experienced stronger growth than the rest of Canada. From 1982 to 1985, Ontario's real output grew by 18.7 per cent, compared to 13.1 per cent for Canada as a whole. Over the same period, Ontario's employment rose by 8.2 per cent, compared to 5.0 per cent in other parts of the country.

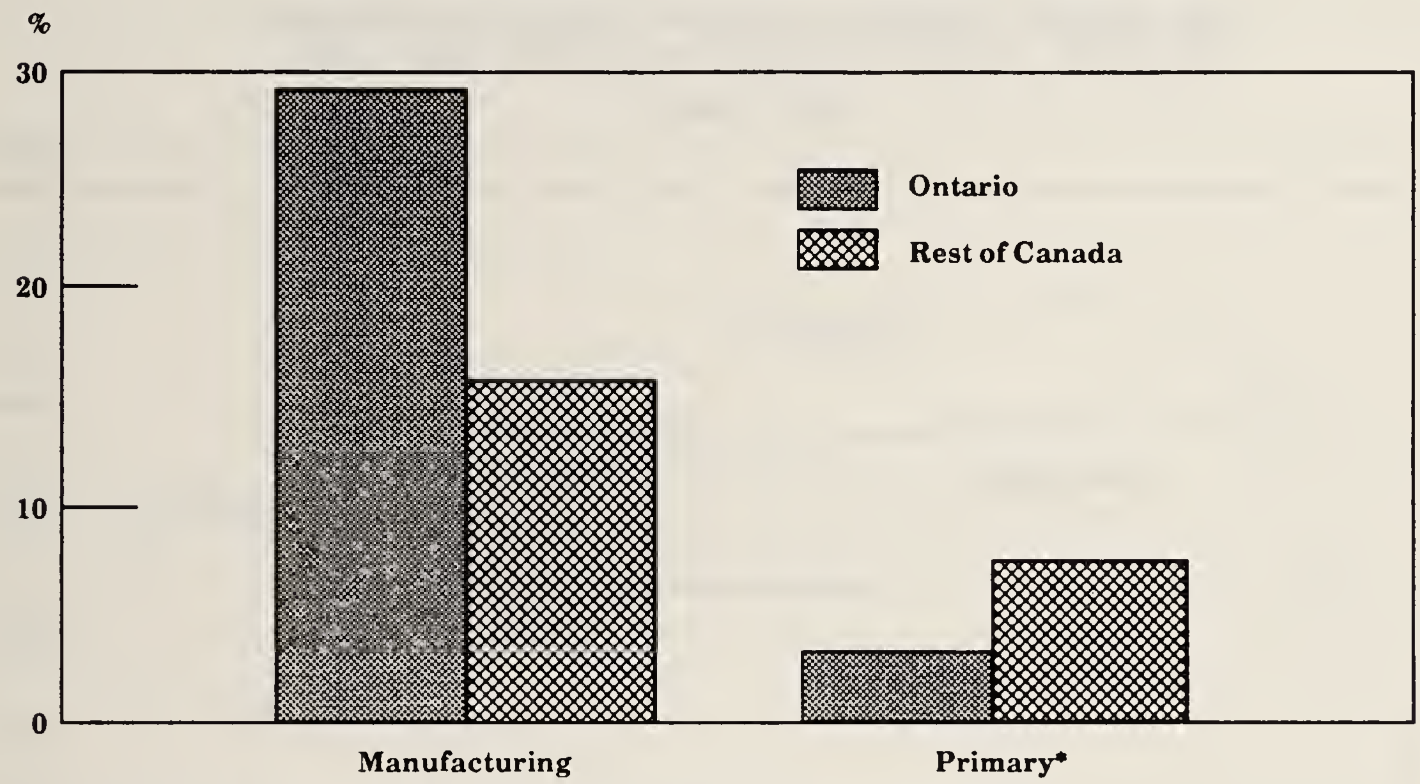
UNEMPLOYMENT RATES BY PROVINCE, SEPTEMBER 1986
(Seasonally-Adjusted)



Source: Statistics Canada.

Ontario's economy is more heavily oriented towards manufacturing and less to primary resource industries than is the rest of Canada. In large part, this orientation accounts for the relatively strong performance of the Ontario economy.

SHARES OF REAL OUTPUT, 1985
MANUFACTURING AND PRIMARY SECTORS

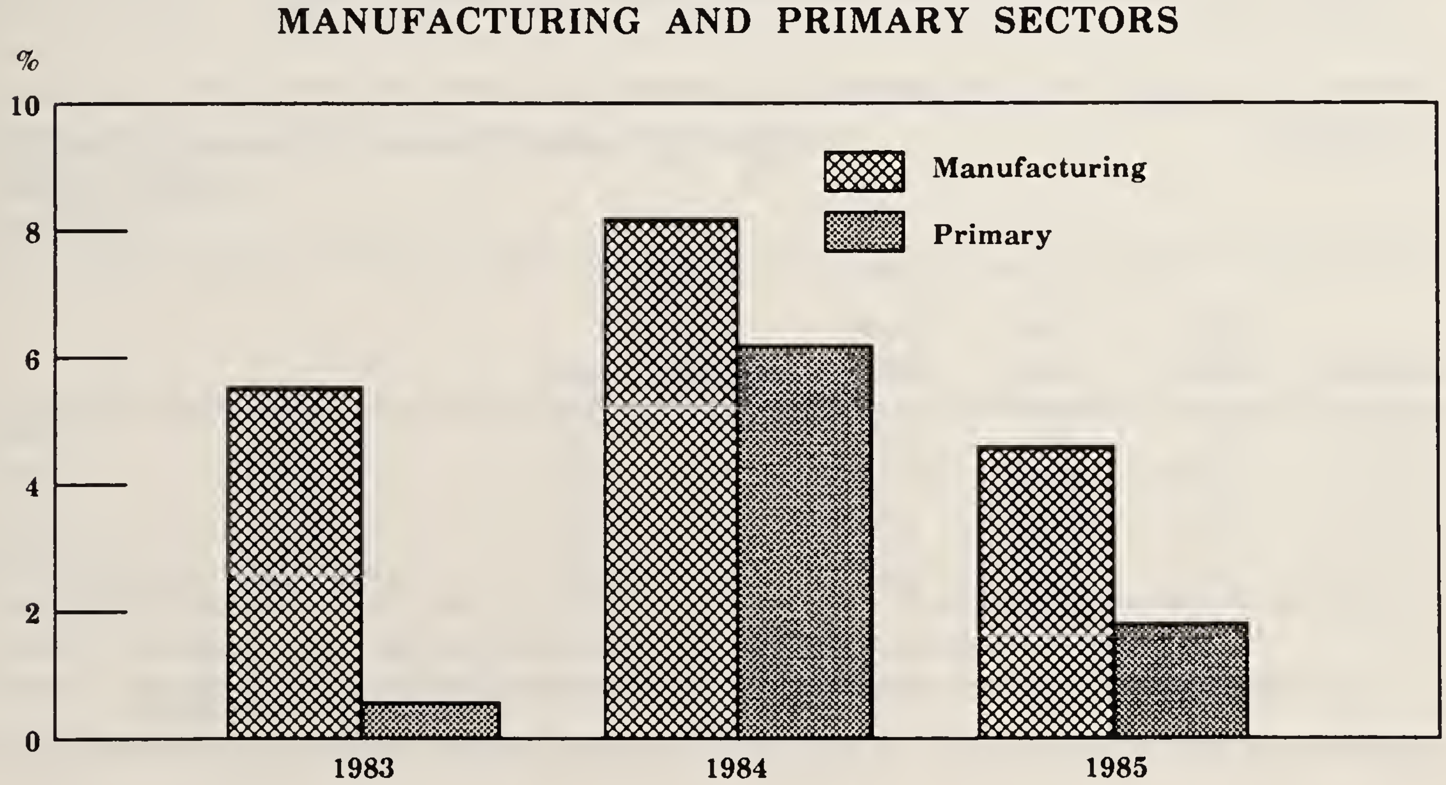


* Agriculture and Fishing, Forestry, Mining, Quarrying and Oil Wells

Source: Statistics Canada and Conference Board of Canada.

During the recovery, growth in manufacturing output, particularly automobile production, has outperformed that of primary industries.

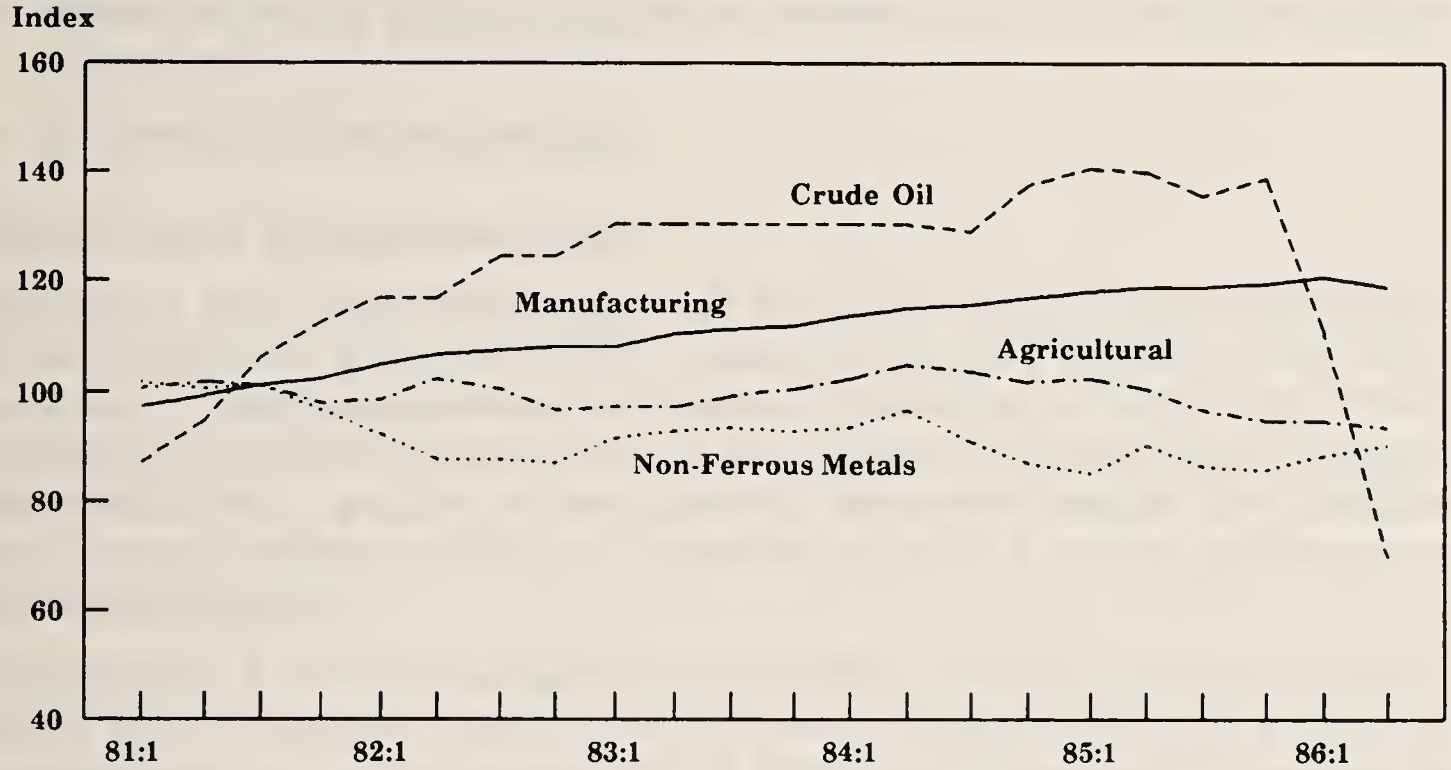
REAL OUTPUT GROWTH IN CANADIAN
MANUFACTURING AND PRIMARY SECTORS



Source: Statistics Canada.

The relative strength in manufacturing is also reflected in the performance of prices in that sector relative to those in the resource sector. Manufacturing prices increased by almost 20 per cent between 1981 and 1986. However, agricultural and metals prices drifted down. Crude oil prices, after rising steadily over the last five years, plummeted in the first half of this year.

MANUFACTURING, AGRICULTURAL, CRUDE OIL AND NON-FERROUS METALS PRICE INDICES
(1981 = 100)



Source: Statistics Canada.

Parts of Ontario or its economy have experienced adverse effects from the generally low commodity prices. For example, Northern Ontario is an important exception to the overall strength in the province's economic performance. Table 1 shows the unemployment rates by region since 1980.

Ontario Unemployment Rates by Region, 1980 to 1986 **Table 1**
(Per Cent)

	East	Central	South West	North East	North West	Ontario
1980	8.0	5.9	9.6	8.0	7.2	6.8
1982	9.2	9.1	11.4	14.8	10.3	9.8
1985	8.6	7.5	8.4	10.6	10.2	8.0
1986 (January-September)	8.0	6.5	7.3	11.1	11.3	7.2

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.
Note: Due to changes in regional boundaries and survey methodology, pre-1984 data are not strictly comparable with later data.

Key Factors and Assumptions: 1986-1987

Ontario's economic performance is closely tied to external developments. The four most important are:

- economic growth, particularly in the United States, but also in Western Europe and Japan;
- economic growth in the rest of Canada and the fiscal actions of the federal government;
- federal monetary policy, changes in interest rates and foreign exchange rates; and
- the price of oil and natural gas.

The U.S. and World Economies

Exports to the United States account for about 35 per cent of Ontario's Gross Provincial Product (GPP). Accordingly, the health of the U.S. economy is vitally important to Ontario. Following a very rapid initial rebound during the first two years of the recovery, the American economy has settled into a pattern of slow growth. Moreover, despite the stimulus from lower oil prices and falling interest rates, the U.S. economy is expected to remain sluggish.

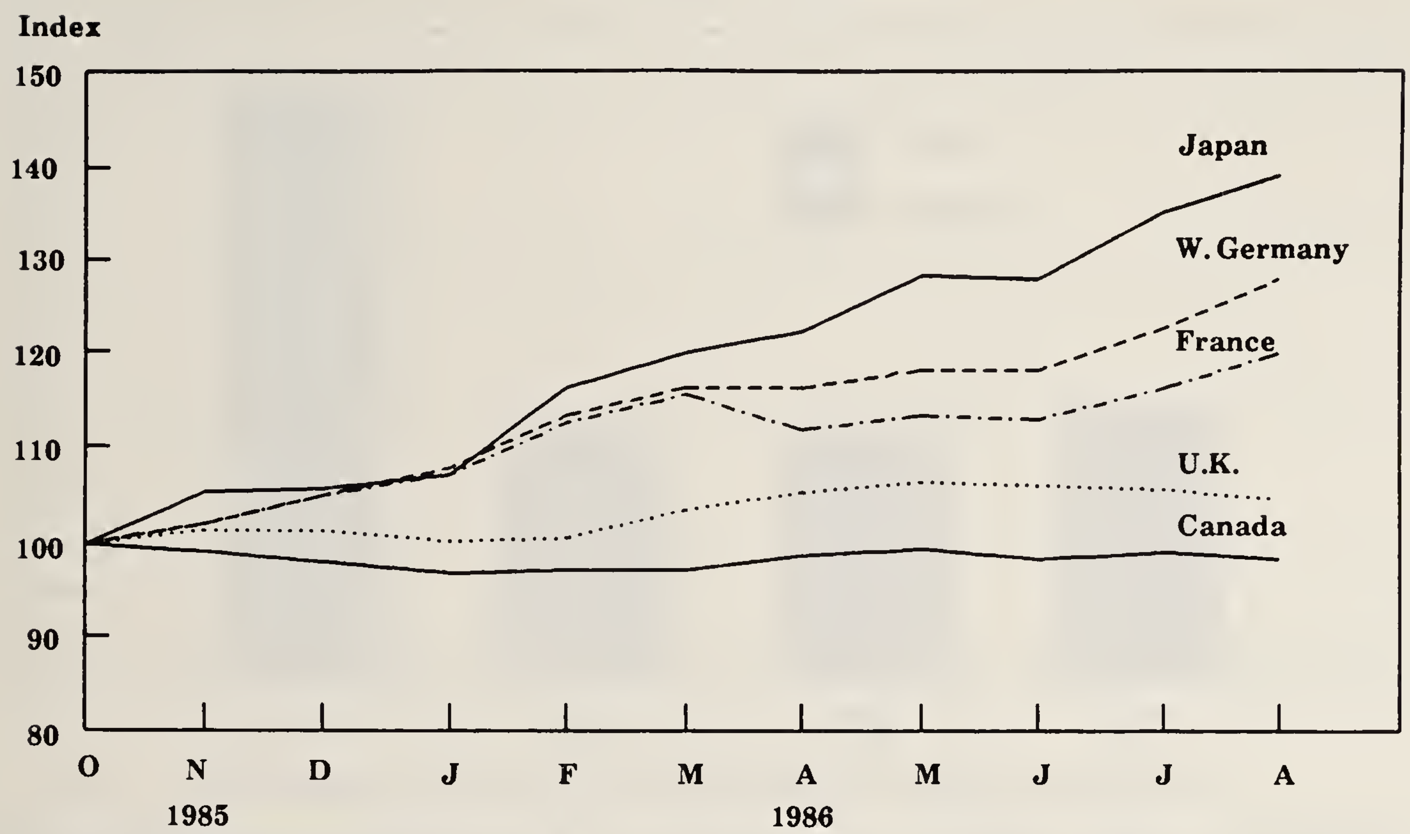
Burdened by a steadily mounting trade deficit, the U.S. economy grew at only a 2.5 per cent real annual rate over the first half of 1986. As a result of a modest pick-up in the second half of 1986, real growth of 2.7 per cent is expected for the year as a whole. While lower oil prices have spurred consumer spending, their short-run negative impacts have been large. Investment spending in the capital-intensive energy sector has collapsed and oil imports are up sharply. The stimulus from recent reductions in U.S. interest rates has been limited to the consumer; business spending is weak.

The trade sector remains the major source of weakness in the U.S. economy. However, there are positive signs. The U.S. dollar has depreciated significantly since the Group of Five (G-5) agreement on exchange rate realignment. For a number of reasons the initial impact has been to widen the trade deficit further this year, but the results of strengthened U.S. competitiveness are expected to be evident in 1987.

In addition to the currency corrections following the G-5 agreement, both West Germany and Japan will have to allow their economies to grow more quickly to absorb U.S. exports. Also, improvements in Third World debt arrangements would facilitate renewed growth of U.S. exports to these countries. This forecast assumes modest improvements on these fronts.

On balance, the U.S. trade performance is expected to improve in 1987; the trade deficit (measured in constant 1982 $) is expected to fall to about $100 billion from $130 billion in 1986.

U.S. DOLLAR EXCHANGE RATES OF MAJOR CURRENCIES
(October 1985 = 100)



Source: Bank of Canada.

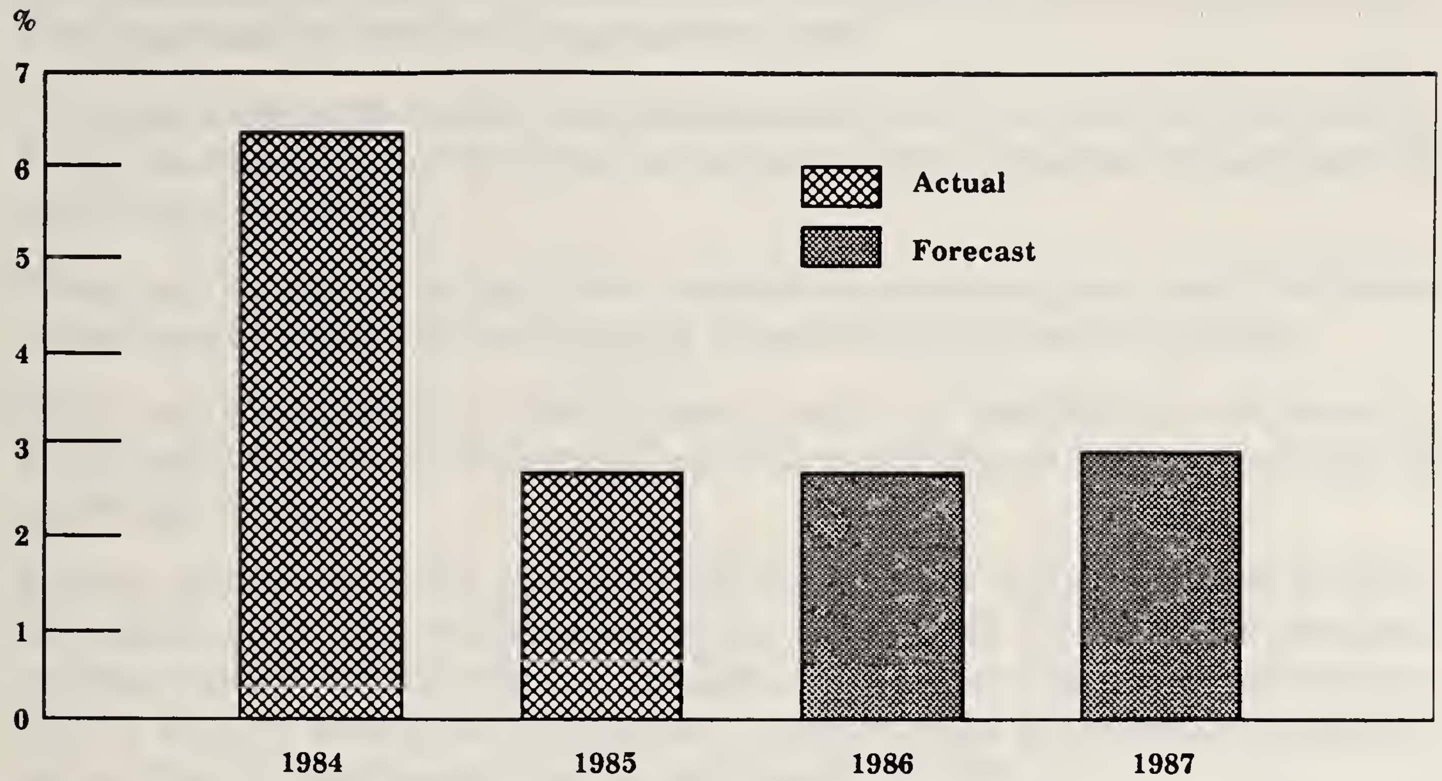
Slow economic growth is producing a record U.S. budget deficit, which is expected to reach close to $230 billion in the current fiscal year. U.S. fiscal policy is expected to become more restrictive in 1987, with or without precise adherence to Gramm-Rudman deficit reduction targets.

- Tax reform could withdraw as much as $11 billion from the economy in 1987, exacerbating the impact of government expenditure restraint on economic growth. In addition, the changes in U.S. tax law shift a greater share of the tax burden to businesses, especially those that are capital intensive. This will have an adverse impact on investment spending.

Monetary policy should continue to play a stimulative role in the economy, providing a partial offset to the trade deficit and tightening fiscal policy. Between January and October 1986, the Federal Reserve Board cut its trend-setting discount rate by 2.0 percentage points, bringing about a significant reduction in short-term interest rates. Further rate reductions are expected next year, providing an incentive to consumer and business spending.

Overall, modest improvement in the trade deficit coupled with further monetary accommodation should produce marginally stronger growth in 1987. Real GNP is forecast to grow at a 2.9 per cent rate. However, tighter fiscal policy and sluggish investment spending will act as impediments to a stronger performance.

U.S. REAL GROWTH



Source: U. S. Department of Commerce and Ontario Ministry of Treasury and Economics.

Continued moderate growth of the economies of other major industrial countries is expected. The current OECD forecast calls for Japanese growth of 3.25 per cent this year, followed by 3 per cent in 1987. The German economy is forecast to expand by 3.5 per cent this year and 3 per cent in 1987. The rest of OECD Europe is expected to achieve growth of 2.75 per cent in 1986 and 2.5 per cent next year.

The Canadian dollar has depreciated significantly against the currencies of Japan, West Germany and France. The recent depreciation of the dollar enhances the competitiveness of Ontario products, both in North American markets and overseas. The Canadian dollar exchange rate against major overseas currencies is not expected to vary significantly from current levels in the short term and thus will continue to contribute to the competitiveness of Canada's trade-sensitive industries. Continued economic growth in these countries should help to sustain Canada's export performance.

The Canadian Economy and Federal Economic Policy

Because of the strong trade links between Ontario and the other provinces, developments elsewhere in Canada have an important bearing on the performance of Ontario's economy. Although interprovincial trade is extremely difficult to measure, Ontario's exports of goods and services to other provinces may account for as much as 15-20 per cent of Gross Provincial Product.

The rest of Canada is expected to grow more slowly than Ontario over the forecast period. Nonetheless, real growth in the rest of Canada is expected to accelerate from 2.4 per cent in 1986 to 3.1 per cent in 1987. Including Ontario, Canadian real GDP is forecast to grow by 3.1 per cent this year and by 3.3 per cent in 1987.

[illegible]

[illegible]

- Canada's unemployment rate is forecast to drop from an annual average of 9.7 per cent in 1986 to 9.4 per cent in 1987.
- Depressed resource prices have dampened growth in the rest of Canada. Large declines in world oil prices have sharply curtailed investment in the oil and gas sector.
- Weak agricultural prices have restrained consumption and business investment in agricultural regions, especially in Western Canada.
- This year's buoyancy in the housing sector is expected to continue in 1987 because of pent-up demand and the possibility of further declines in mortgage rates.
- Export growth is weak this year in response to lower demand growth throughout the international economy, especially for resource products such as metals, oil and agricultural products. However, an improvement in the world's economic environment and modest increases in resource prices should lead to stronger export growth in 1987.

Federal fiscal policy is an important element in the economic outlook. In 1985, federal expenditures of $123 billion amounted to 25.7 per cent of Canada's GDP. Given the relative magnitude of these expenditures, changes in federal spending can have a profound impact on economic performance.

Similarly, federal fiscal policy can affect economic activity through taxation. In 1985, federal revenues, including investment income and CPP contributions, amounted to $92.3 billion or 19.4 per cent of Canadian GDP.

It is assumed for the forecast that the federal government will not alter the fiscal policy stance as announced in the February 1986 budget and reaffirmed in the September statement by the Minister of Finance.

- In the current forecast it is assumed that federal tax and expenditure policies do not change in the 1987-88 fiscal year.

Interest Rates and Exchange Rates

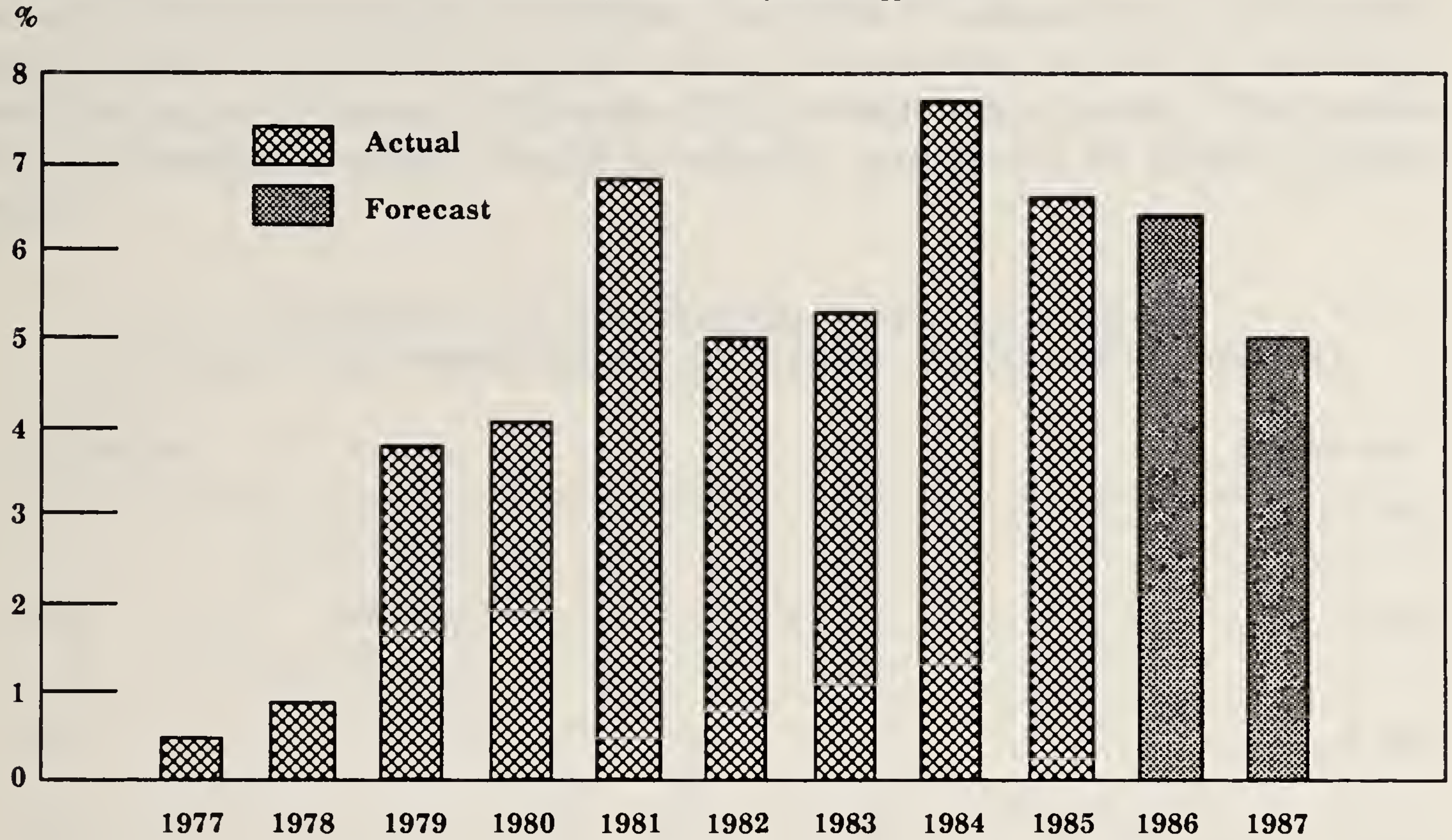
Interest rates are a key determinant of demand for housing, consumer durables and business investment. Recently, interest rates have been declining. After rising to 13 per cent in February 1986, the prime rate fell to 9.75 per cent in July, its lowest level in eight years.

Nominal interest rates are expected to decline further over the forecast horizon. By the end of 1987, the prime rate is expected to decline to 8.5 per cent. This is in line with the expectation of continuing low domestic inflation and further discount rate cuts in the U.S.

Spending is also greatly affected by real interest rates -- that is, nominal interest rates minus the rate of inflation. Real rates have been very high in the 1980s relative to earlier periods. In 1984, the real prime rate was over 7.5 per cent. Given an expected 3.5 per cent rate of inflation, the real prime

rate is expected to fall to 5.0 per cent in 1987. This represents an important stimulus to growth in spending.

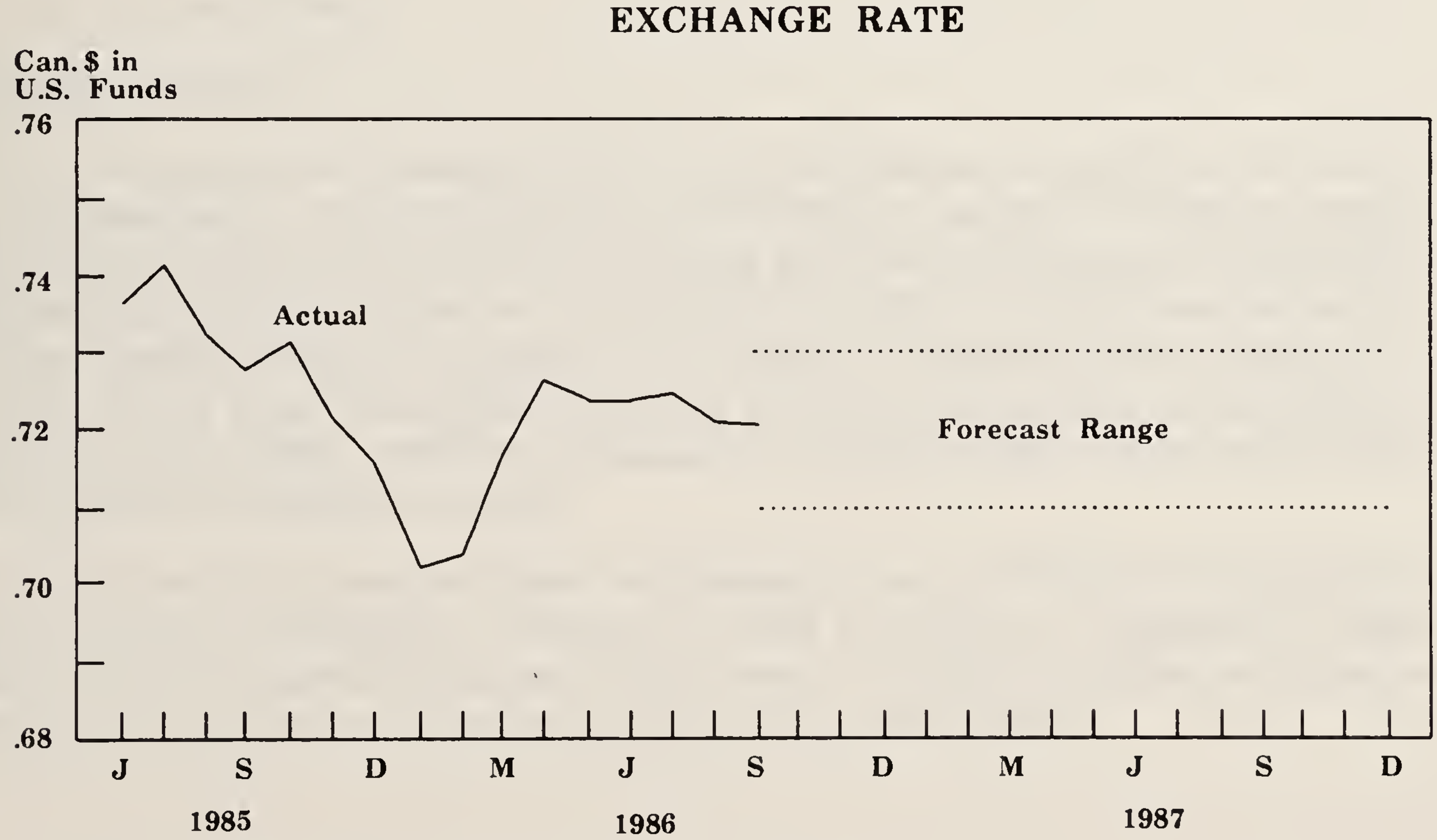
REAL PRIME RATE



Source: Bank of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics.

The movement of interest rates in Canada depends in part on the Bank of Canada's decisions with respect to monetary and exchange rate policies. The Bank of Canada is expected to continue to support the Canadian dollar in the 71-73 cents U.S. range by maintaining, on average, a 100-200 basis point differential between Canadian and U.S. short-term interest rates.

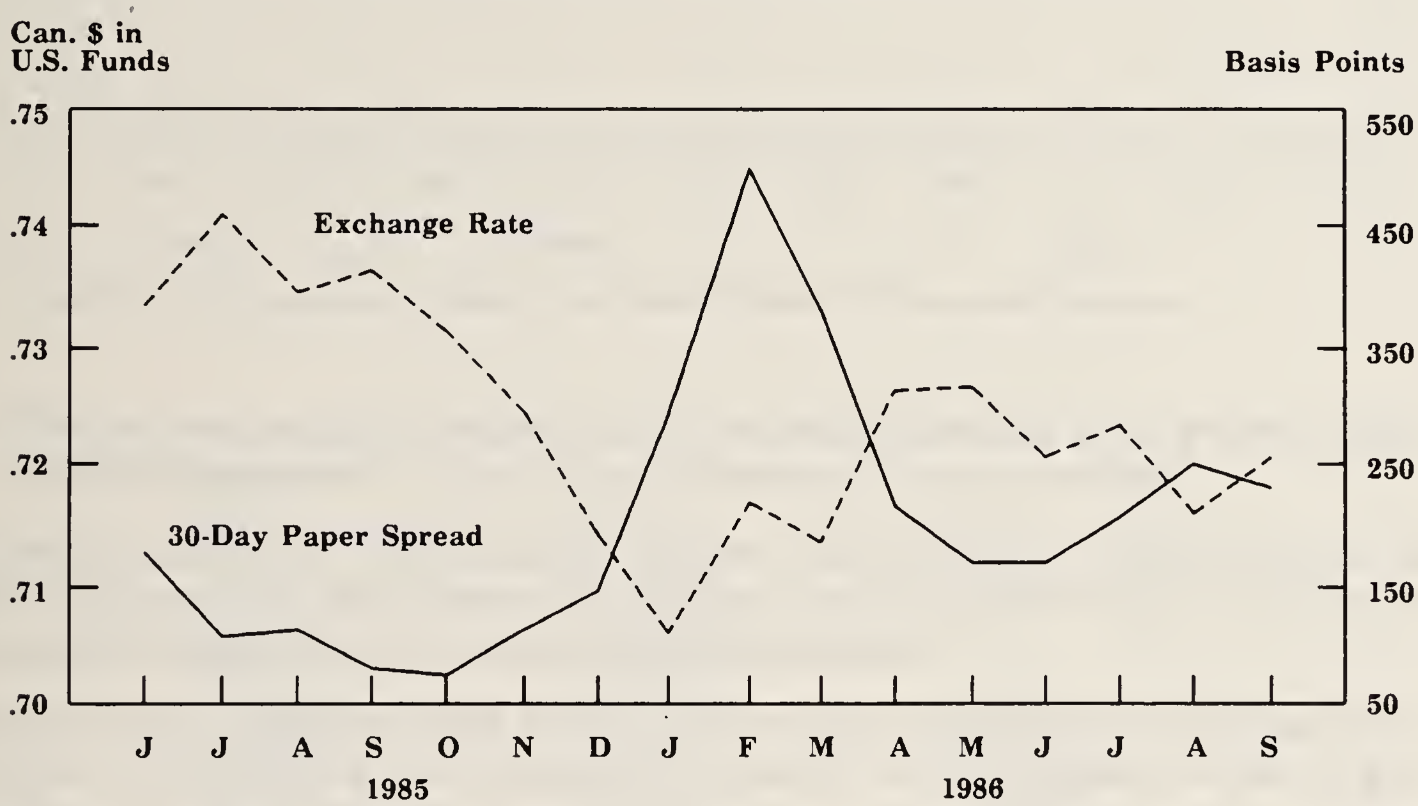
EXCHANGE RATE



Source: Bank of Canada and Ontario Ministry of Treasury and Economics.

The forecast interest rate differential represents a significantly narrower spread than earlier in 1986. At that time, the Bank intervened to support the dollar and raised the interest rate differential to over 500 basis points. This forecast does not anticipate future downward pressure on the Canadian dollar. However, were this to happen, the Bank of Canada would likely once again support the dollar through direct intervention in foreign exchange markets and a widening of Canada-U.S. interest rate spreads. The growth of the Canadian economy would be affected negatively by higher interest rates.

CANADA - U.S. EXCHANGE RATE AND THE CANADA - U.S. SHORT-TERM INTEREST RATE DIFFERENTIAL



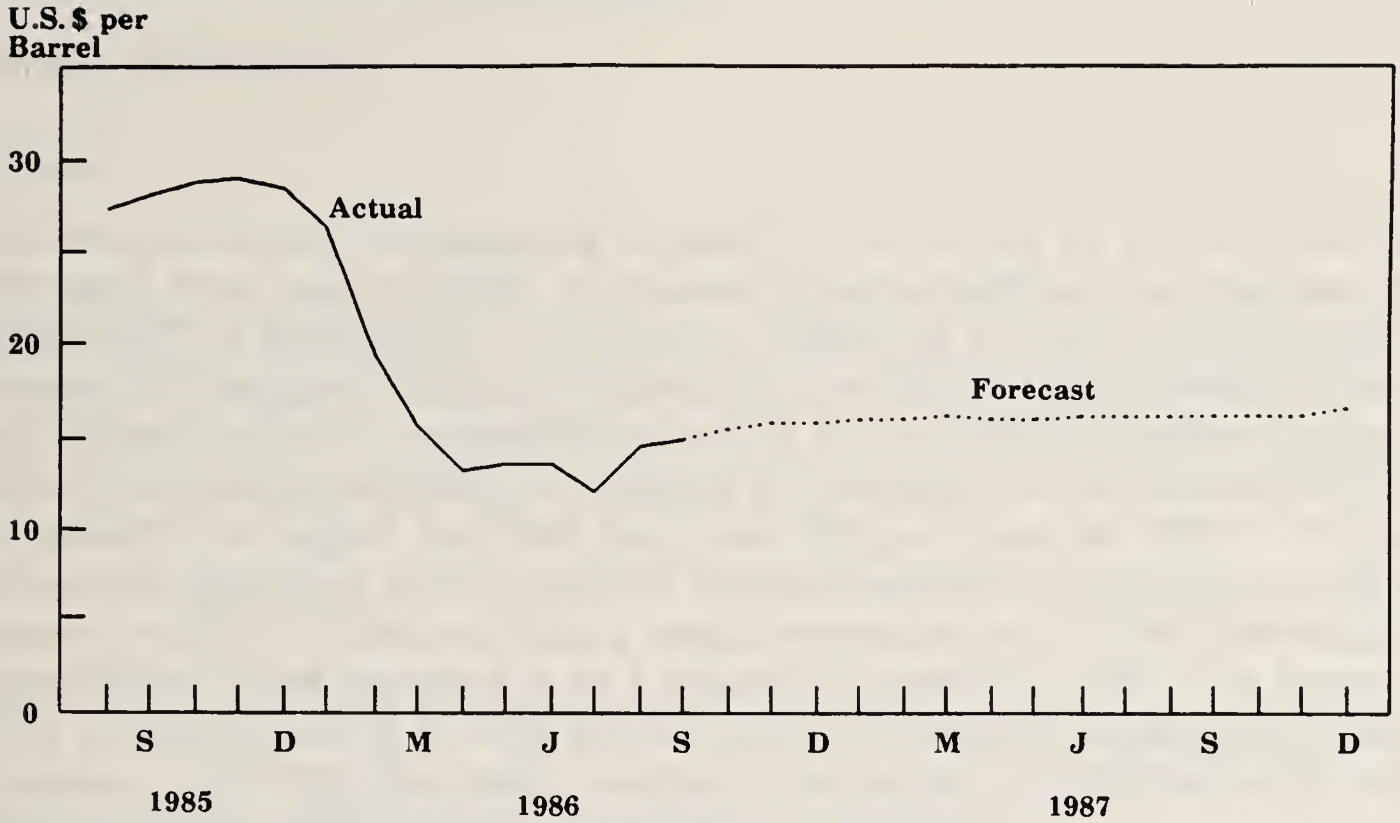
Source: Bank of Canada.

Energy Prices

Over the past decade, sharply higher real petroleum prices led to reductions in demand and the development of alternative sources of energy supply, reducing OPEC's share of world markets and eroding its power to determine prices unilaterally. However, at the end of 1985, in a bid to restore control, Saudi Arabia sharply increased its oil output. This triggered a collapse of world prices from about $28 (U.S.) per barrel at the time to under $10 per barrel in mid-1986. OPEC's agreement in August 1986 to lower output has led again to a firming in prices.

Volatile world oil markets have introduced a large element of uncertainty into economic forecasting. However, world oil prices are expected to reach $16 (U.S.) per barrel by the end of the year. In 1987 and subsequent years, nominal oil prices are assumed to rise in line with inflation.

WORLD OIL PRICES



Source: U. S. Department of Energy and Ontario Ministry of Treasury and Economics.

- The key assumption underlying the expected firming of oil prices is that OPEC's agreement to limit its production will prove durable.

Ontario's oil bill in 1985 was $6.7 billion. The decline in the price of oil to $16 U.S./barrel in 1986 lowers the annual outlay by $2.6 billion. This is an important stimulus to economic activity in Ontario.

Natural gas prices are also falling due to the competitive pressures from refined oil products and government steps to deregulate natural gas markets. Large industrial users of gas have already been able to obtain price reductions of 15 to 30 per cent and lower prices for other gas users are being negotiated. Ontario's wholesale gas bill of $2.8 billion is likely to be reduced by about $500 million annually.

While lower oil prices provide a net stimulus to the Ontario economy, the decline in oil prices has had an adverse effect on growth in the oil-producing regions of Canada. Investment in the energy sector has been particularly hard hit, adversely affecting the demand for some Ontario goods. Similarly, lower oil prices have weakened energy investment in the U.S. and economic performance in its oil-producing regions. This weakens Ontario's exports to those markets as well.

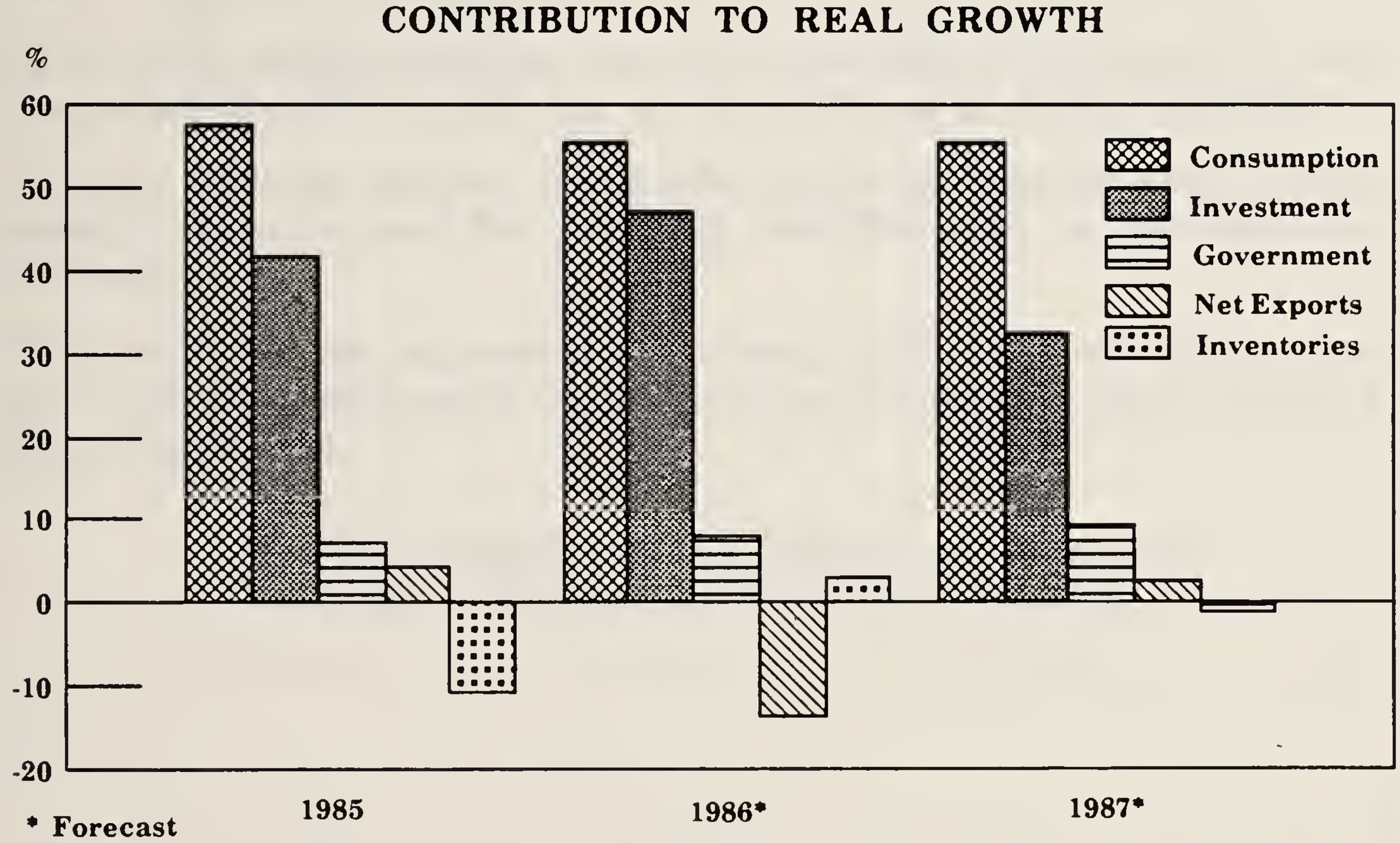
Short-Term Outlook: 1986-1987

Sources of Growth

Overview

The Ontario economy is expected to grow in real terms by 4.1 per cent in 1986 and 3.6 per cent in 1987. In terms of current dollars, the increase of nominal GPP is forecast at 7.1 per cent in 1986 and 6.7 per cent next year. Increases in consumer demand account for over half of the growth in real output in both years. Investment, primarily in residential construction and in machinery and equipment, is expected to generate over 40 per cent of the real growth in output in 1986 and over 30 per cent in 1987. Total government spending will provide a modest additional stimulus to the economy in 1987. After making a small contribution in 1986, inventory accumulation is not expected to be a source of growth in 1987. Net exports will be a drag on growth in 1986 as the increase in imports outpaces the gain in exports. In 1987, the trade position is expected to stabilize with net exports making a small positive contribution to growth.

CONTRIBUTION TO REAL GROWTH



Source: Ontario Ministry of Treasury and Economics.

Consumer Demand

Consumer spending, which represents over half of aggregate spending, will be the main contributor to sustained expansion. In particular, the consumption of durables will remain robust. Personal expenditures on all goods and services are forecast to grow by 4.1 per cent and 3.7 per cent in real terms during 1986 and 1987 respectively.

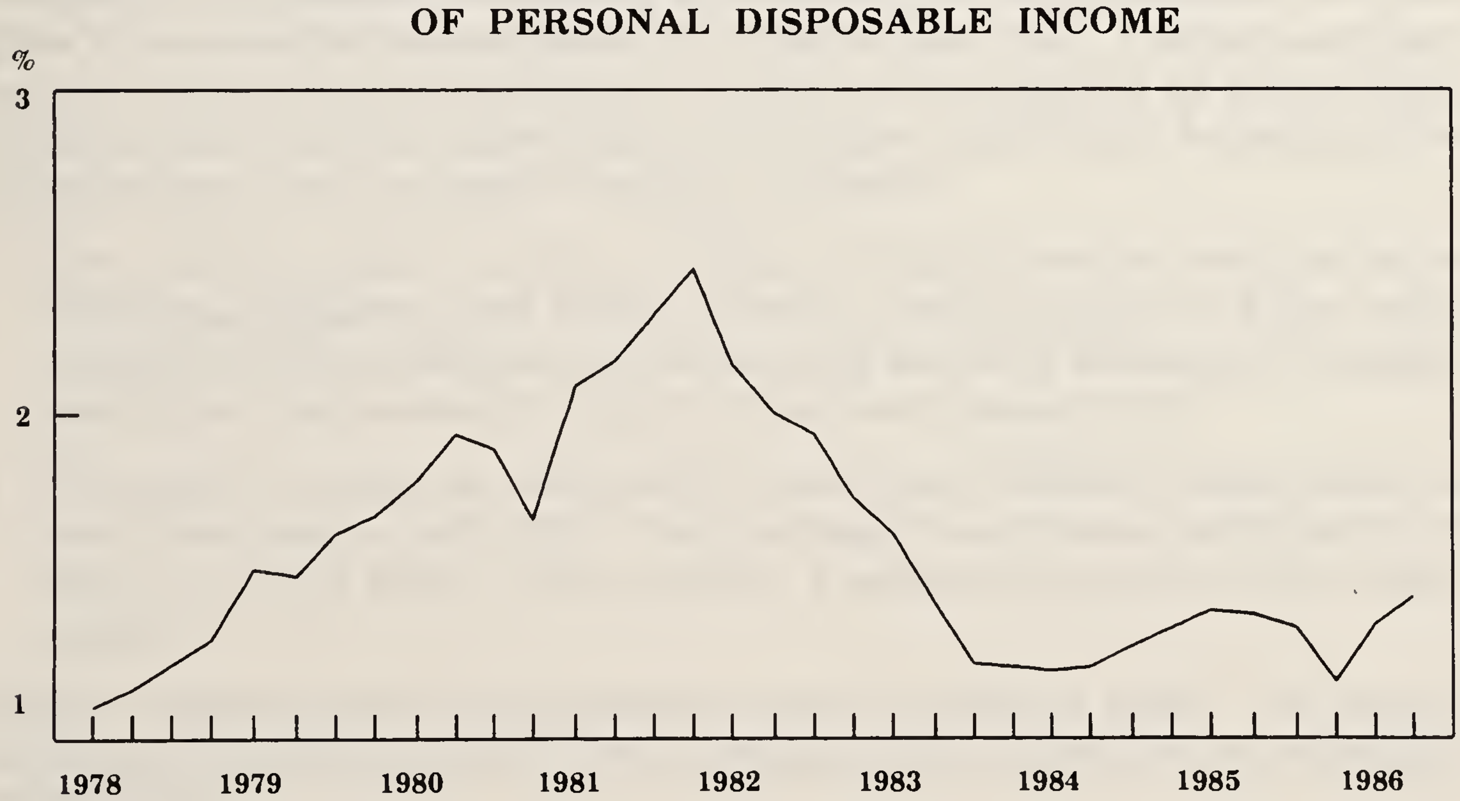
Due to low inflation, declining unemployment and falling interest rates, consumer confidence is expected to remain firm. This is particularly true for Ontario since it is much less vulnerable than other parts of Canada to the

negative side effects of low oil and commodity prices. According to the 1986 summer consumer survey by the Conference Board of Canada, the Ontario index of consumer attitudes climbed to 132.4 in the second quarter of 1986, up from 121.1 in the first quarter.

There are a number of factors that will influence consumer expenditures in the short term:

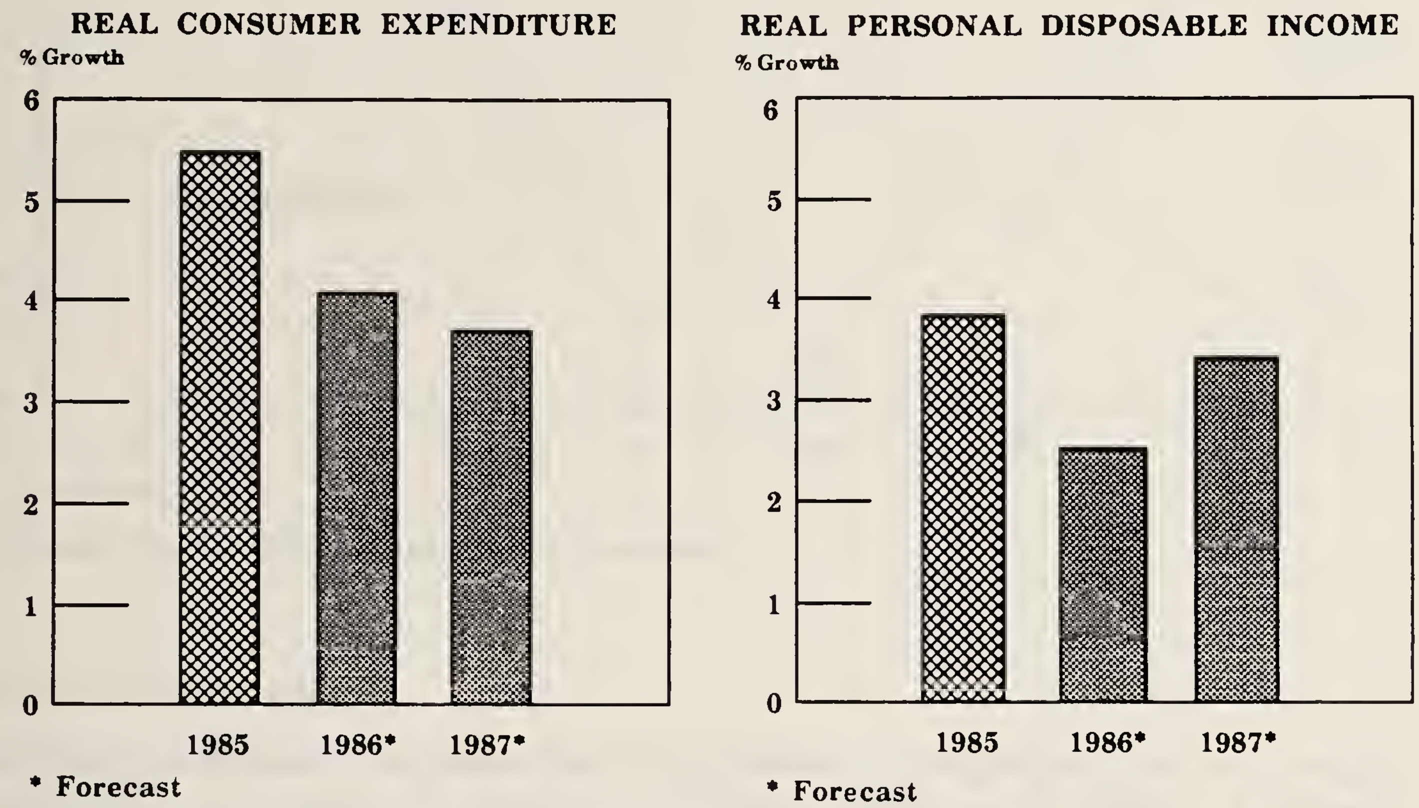
- There will be a modest deceleration in nominal personal income growth, to 7.8 per cent in 1986, down from 8.2 per cent in 1985. This reflects the impact of a decrease in deposit rates on interest income and a higher concentration of job creation in the lower-paying service sector. Growth in personal income will slow further to 7.3 per cent in 1987.
- Real personal income will continue to rise, posting a 3.7 per cent gain in both 1986 and 1987.
- The higher federal personal income tax rates that came into effect this year will tend to dampen expenditure growth, but this is expected to be cushioned by the impact of low oil prices and a declining savings rate. Real personal disposable income is forecast to grow by 2.5 per cent this year and by 3.4 per cent in 1987.
- The Ontario personal savings rate, which averaged 17.2 per cent in 1985, is expected to decline to 15.9 per cent in 1986 and 15.6 per cent in 1987.
- A strong housing market, along with declining interest rates, should sustain robust demand for consumer durables such as furniture and appliances.
- With credit interest payments remaining relatively moderate as a per cent of personal disposable income, consumers are in a good position to take on more debt.

CREDIT INTEREST PAYMENTS AS A SHARE OF PERSONAL DISPOSABLE INCOME



Source: Statistics Canada.

Retail sales, which represent about 45 per cent of personal consumption on goods and services, are forecast to grow by 8.1 per cent this year and by 7.0 per cent next year. Significant gains are occurring in sales of household appliances, furniture and home entertainment products. The strong growth in sales of these particular goods is due, to a significant extent, to the buoyant housing market.



Source: Ontario Ministry of Treasury and Economics.

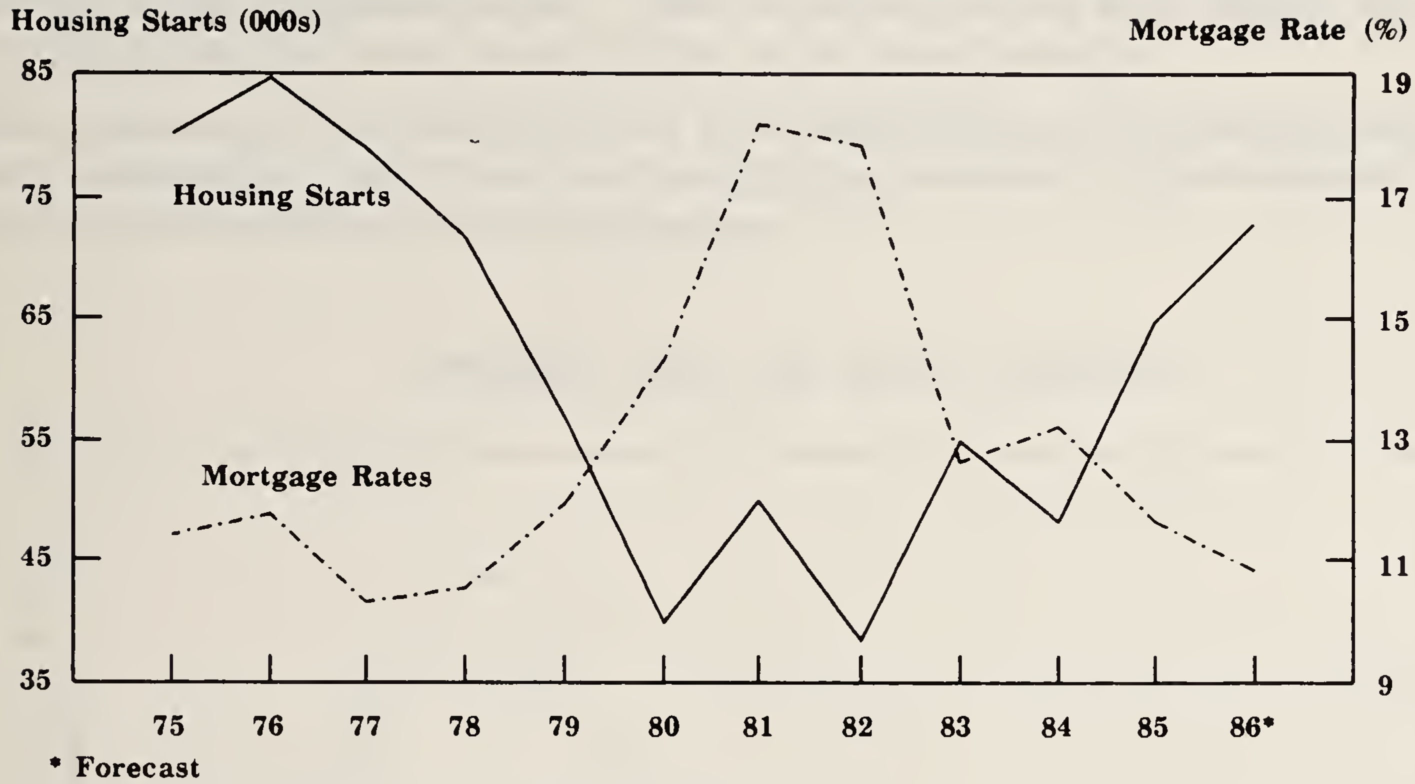
Housing

Buoyancy in the housing sector will persist for the remainder of 1986 and continue into 1987. Residential construction, which includes renovation activity, is expected to be a major contributor to growth. Accordingly, residential investment is expected to climb by over 20 per cent in 1986 and grow at a somewhat slower rate of 13.5 per cent in 1987. Falling mortgage interest rates, pent-up demand from the earlier period of record-high interest rates and the expectation of further significant housing price increases have led to a surge of buying in Ontario.

- Over the first eight months of 1986, housing prices for new homes in Kitchener-Waterloo and Metro Toronto rose 16.0 and 12.6 per cent, respectively, from last year, while housing starts for Kitchener-Waterloo and Metro Toronto rose 47.5 and 27.9 per cent, respectively.
- Shortages of materials and skilled labour have delayed construction of many new homes until 1987. The shortage of new homes, combined with delayed closing dates in that market, has spurred growth in the resale market.

Ontario housing starts are expected to reach 73,000 for 1986. The pace of activity will pick up in 1987, with housing starts rising to an estimated 77,000 units.

ONTARIO HOUSING STARTS AND MORTGAGE RATES



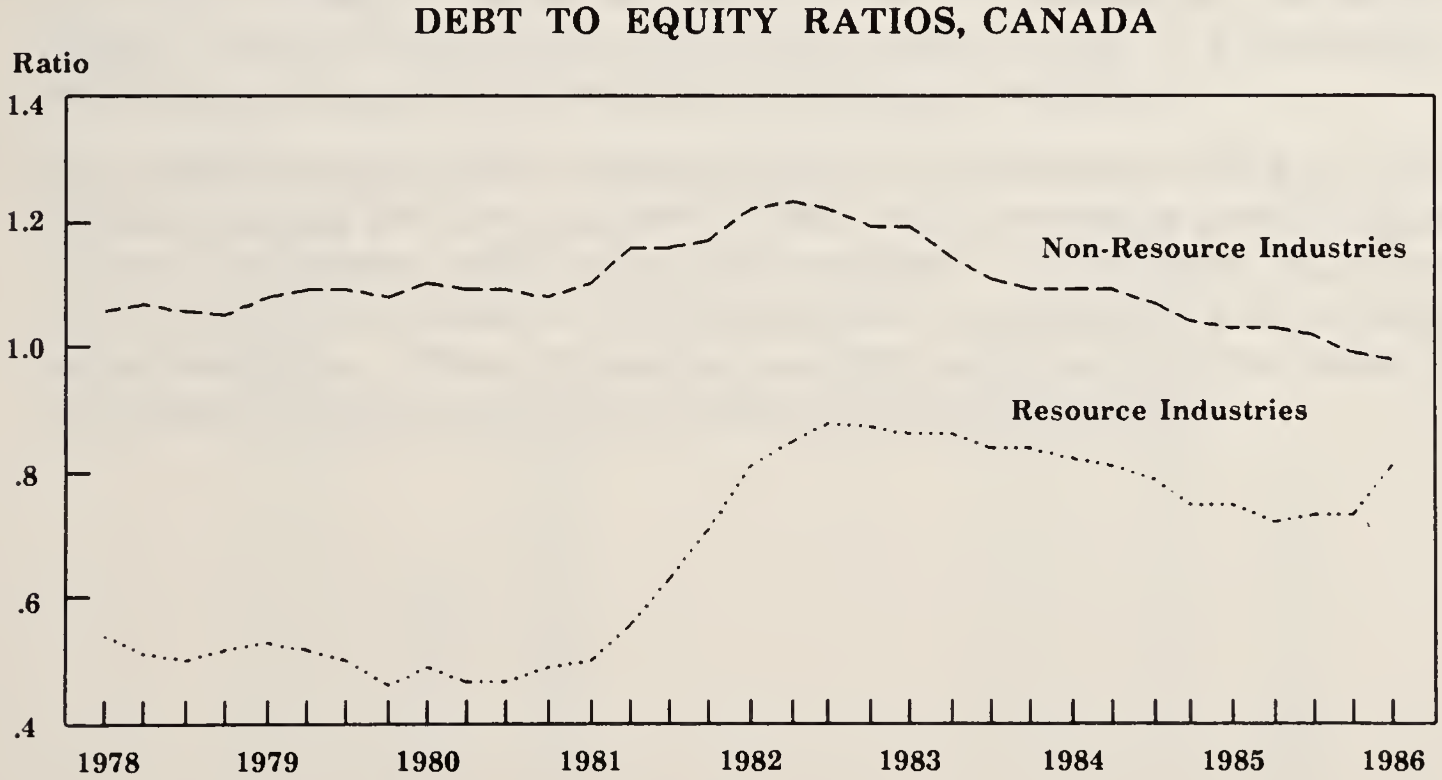
Source: Canada Mortgage and Housing Corporation.

Business Investment

Business investment in plant and equipment is expected to be a major contributor to growth in Ontario in both 1986 and 1987. A strong competitive position, improvements in corporate balance sheets since the recession, the recovery of corporate profits, improved business confidence in the sustained expansion of the economy and declining interest rates have combined to create a very favourable climate for investment.

Corporate profits are forecast to grow by 7.5 per cent in 1986 and a further 6.1 per cent in 1987.

DEBT TO EQUITY RATIOS, CANADA

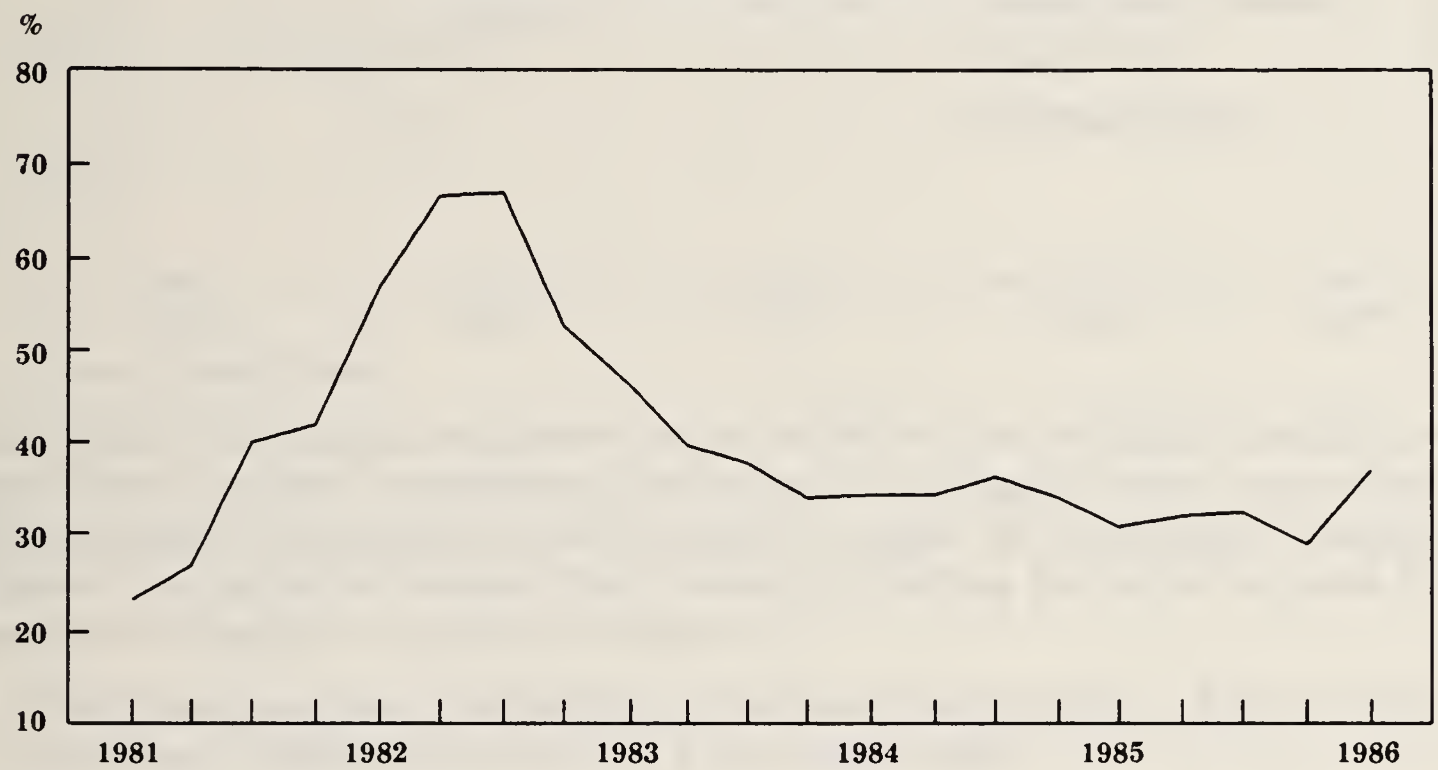


Source: Statistics Canada.

The recovery of profits, the reduction in debt payments due to lower interest rates, and the rapid fall in inflation have led to an improvement in the health of the corporate sector. Debt to equity ratios have fallen more quickly in the non-resource sector than in the resource sector.

Simultaneously, the interest service ratio, which reflects interest payments as a percentage of cash flow, has been falling because of improvements in corporate incomes and lower debt charges.

INTEREST SERVICE RATIO, CANADA

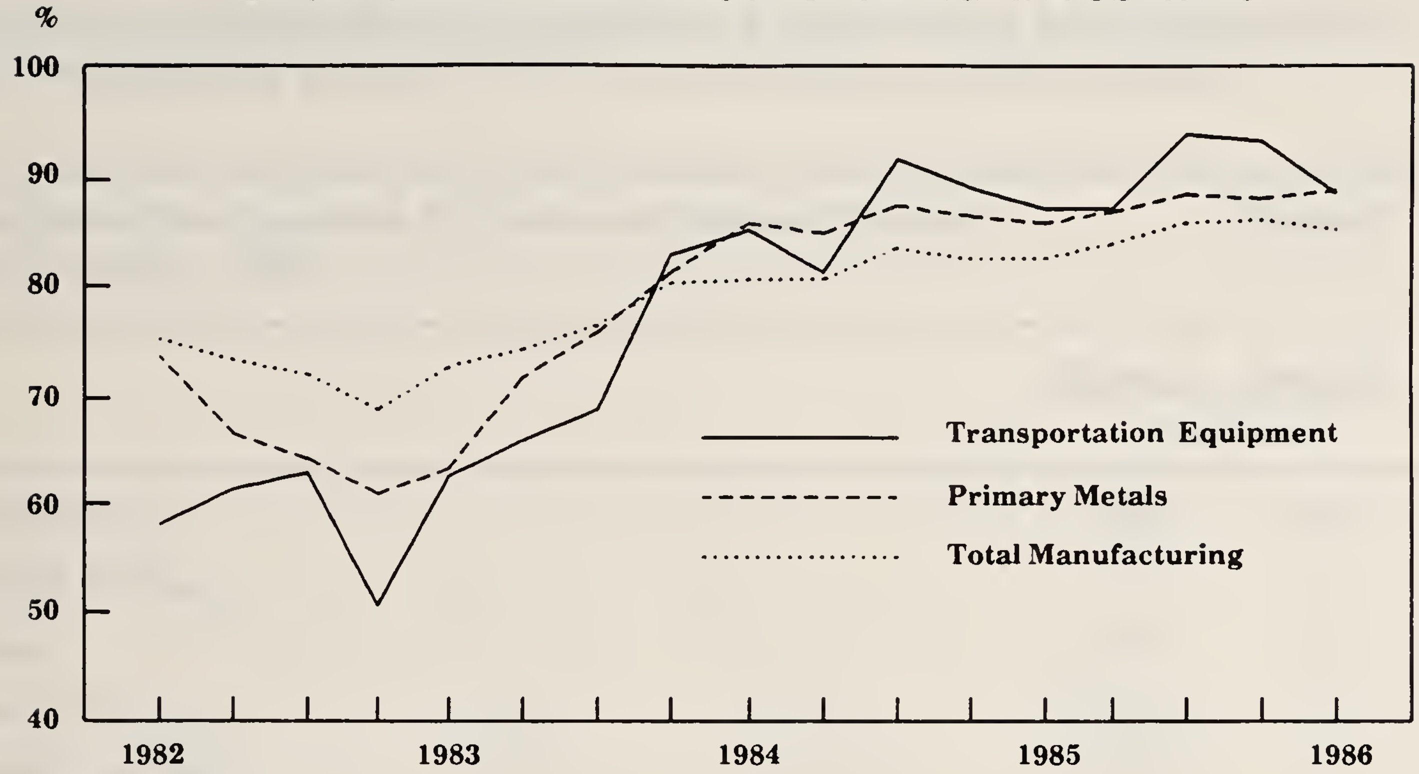


Source: Statistics Canada.

Although capacity utilization rates remain low by historical standards, they have been moving upwards. The current investment expansion reflects the fact that many sectors are reaching the limit of their useable capacity.

- Capacity utilization across all goods-producing industries, excluding energy, stood at 79.9 per cent in the first quarter of 1986, 13.8 percentage points higher than at the lowest point during the recession.
- The manufacturing sector was estimated to be operating at 85.6 per cent capacity during the first quarter of 1986, 16.9 percentage points higher than at the lowest point during the recession. Utilization has been running at higher rates in the transportation equipment and primary metal industries. These industries are expected to account for much of the growth in capital spending in the manufacturing sector.

CANADIAN CAPACITY UTILIZATION RATES FOR SELECTED MANUFACTURING INDUSTRIES

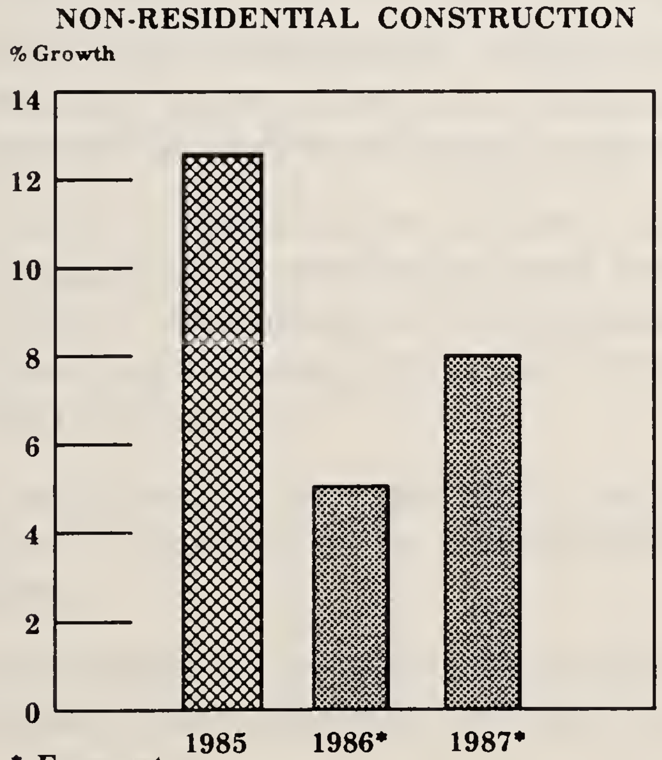


Source: Bank of Canada.

Although factors such as interest rates, inflation and corporate profits are important in the investment decision, the single most important determinant of investment is the outlook for sales. In this regard, demand growth is expected to remain firm, thereby providing the main impetus for continued strength in business investment.

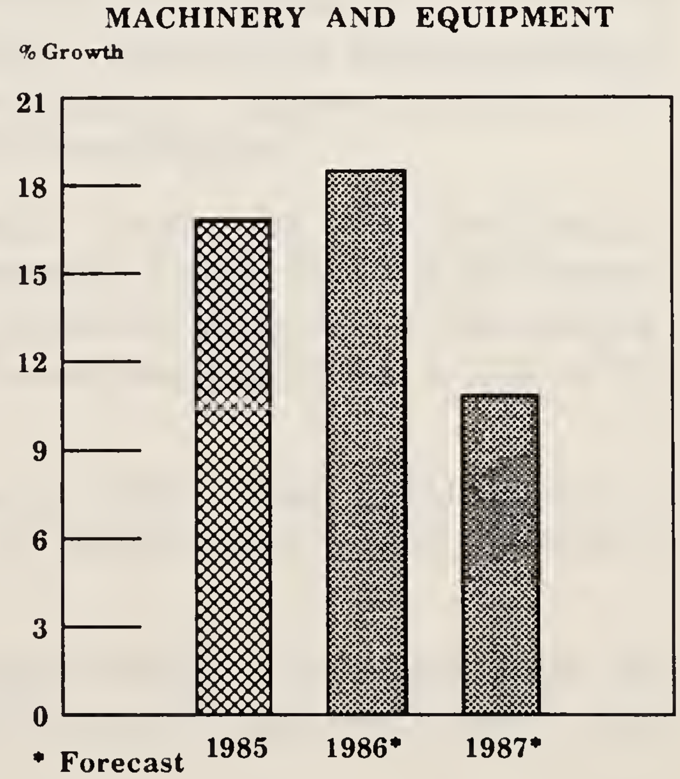
- Total business non-residential investment will post a 13.6 per cent increase in 1986, and a further 9.8 per cent in 1987.
- Investment in non-residential structures will increase moderately, expanding by 5.1 per cent in 1986 and 8.0 per cent in 1987.
- Machinery and equipment spending will make the largest contribution to growth in business non-residential investment, expanding 18.5 per cent this year. The pace of activity will be slower in 1987 but machinery and equipment investment is still expected to advance by a solid 10.8 per cent.

NON-RESIDENTIAL CONSTRUCTION



* Forecast

MACHINERY AND EQUIPMENT



* Forecast

Source: Ontario Ministry of Treasury and Economics.

Exports and Imports

Ontario's trade performance depends, to a large extent, on developments in the United States which is by far our most important trade partner.

Ontario Merchandise Export and Import Shares, by Country, 1985 **Table 2**

	Exports	Imports
	% of Total	
United States	90.8	83.4
United Kingdom	1.5	1.7
Japan	0.8	3.2
West Germany	0.6	1.7
Other Countries	6.3	10.0
All Countries	100.0	100.0

Source: Statistics Canada and Ontario Ministry of Industry, Trade and Technology.

After being the engine of growth in the early years of the recovery, trade is currently a drag on economic growth. Imports are rising more rapidly than exports, resulting in declining net exports.

- Weak export growth in 1986 is due to sluggish economic performance in the U.S. In addition, slower growth in the rest of Canada, partly because of low oil prices, will limit the advance of Ontario's interprovincial exports.
- The U.S. market for new cars and light trucks is not expected to repeat gains made in 1984 and 1985. Nonetheless, as a result of the product mix of the Ontario auto industry, some further modest increases of its exports to the U.S. are expected. While the auto sector will be a less important source of export growth, underlying strength in replacement demand is expected to ensure no drastic reversal for the industry.
- Ontario's spending on imports is being boosted by the spending on investment in machinery and equipment, which has a high import content. Spending on foreign-made consumer durables is also strong. Spending for energy imports will decline substantially due to the recent fall in oil prices.

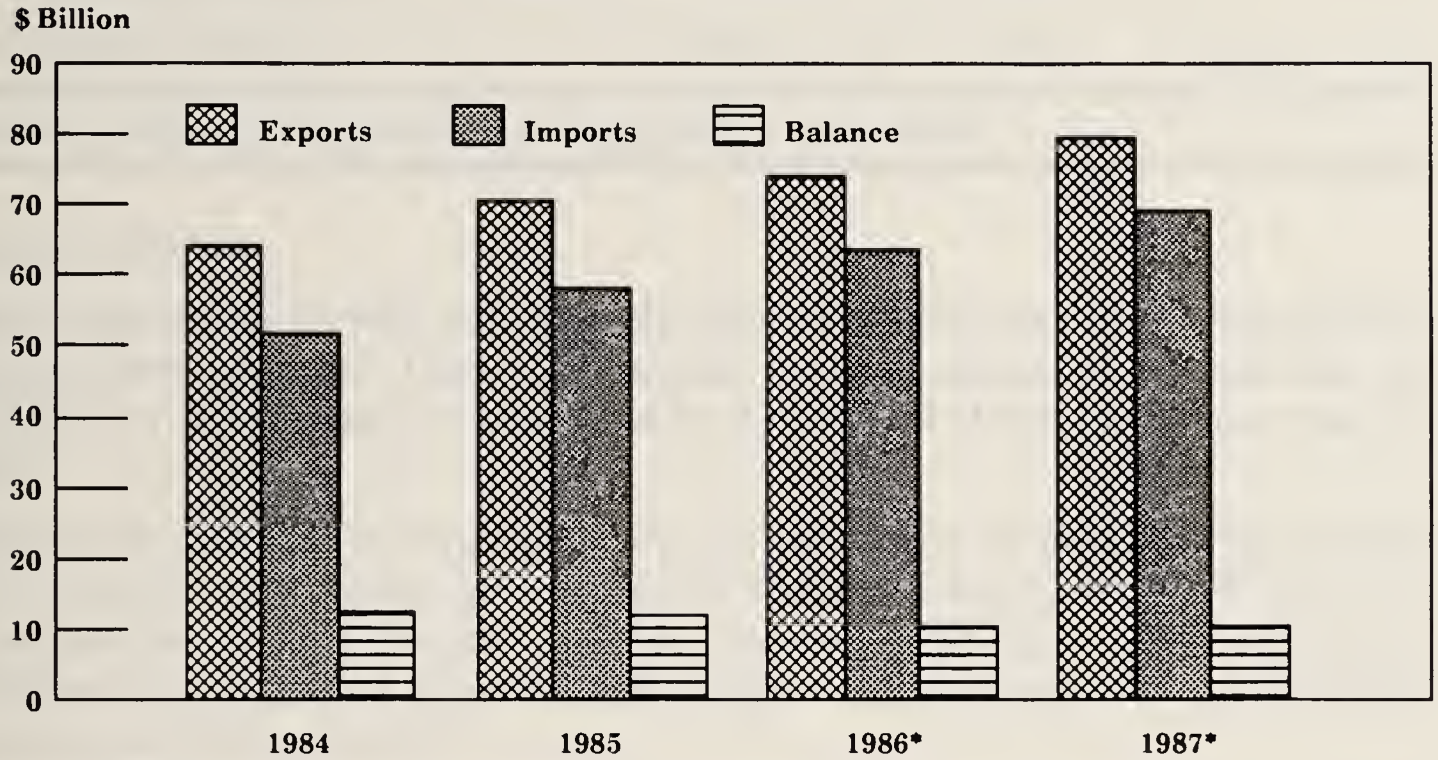
The trade balance is expected to improve in 1987. More rapid growth in exports is expected to be accompanied by moderation in the growth of imports.

- As changes in trade flows typically lag exchange rate adjustments, the impact of the depreciation of the Canadian dollar against European and

Japanese currencies will not become apparent until 1987. This will enhance the competitiveness of Ontario's exports overseas, and improve Ontario's competitiveness in the U.S. market against exports from other countries.

- In addition, low oil prices will directly contribute to a larger trade surplus by reducing Ontario's energy import bill. They should also result in healthy growth in consumer spending in the United States, leading to increased demand for Ontario exports.

ONTARIO TRADE POSITION



* Forecast

Source: Ontario Ministry of Treasury and Economics.

Labour Markets

Overview

Continued economic growth will result in further employment creation and a falling unemployment rate. The Ontario economy is expected to create 156,000 jobs in 1986 and 114,000 in 1987. The unemployment rate is expected to drop from a 1986 average of 7.0 per cent to 6.7 per cent in 1987, as growth in employment outpaces increases in the labour force.

Ontario Labour Market Outlook **Table 3**

	1985	1986 (000s)	1987	1985	1986 (percentage growth)	1987
Labour Force	4,787	4,899	5,010	2.6	2.3	2.3
Employment	4,402	4,558	4,672	3.7	3.5	2.5
Job Creation	159	156	114	-	-	-
Unemployment	385	341	338	-	-	-
Unemployment Rate (%)	8.0	7.0	6.7	-	-	-
Participation Rate (%)	68.0	68.5	69.1	-	-	-

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

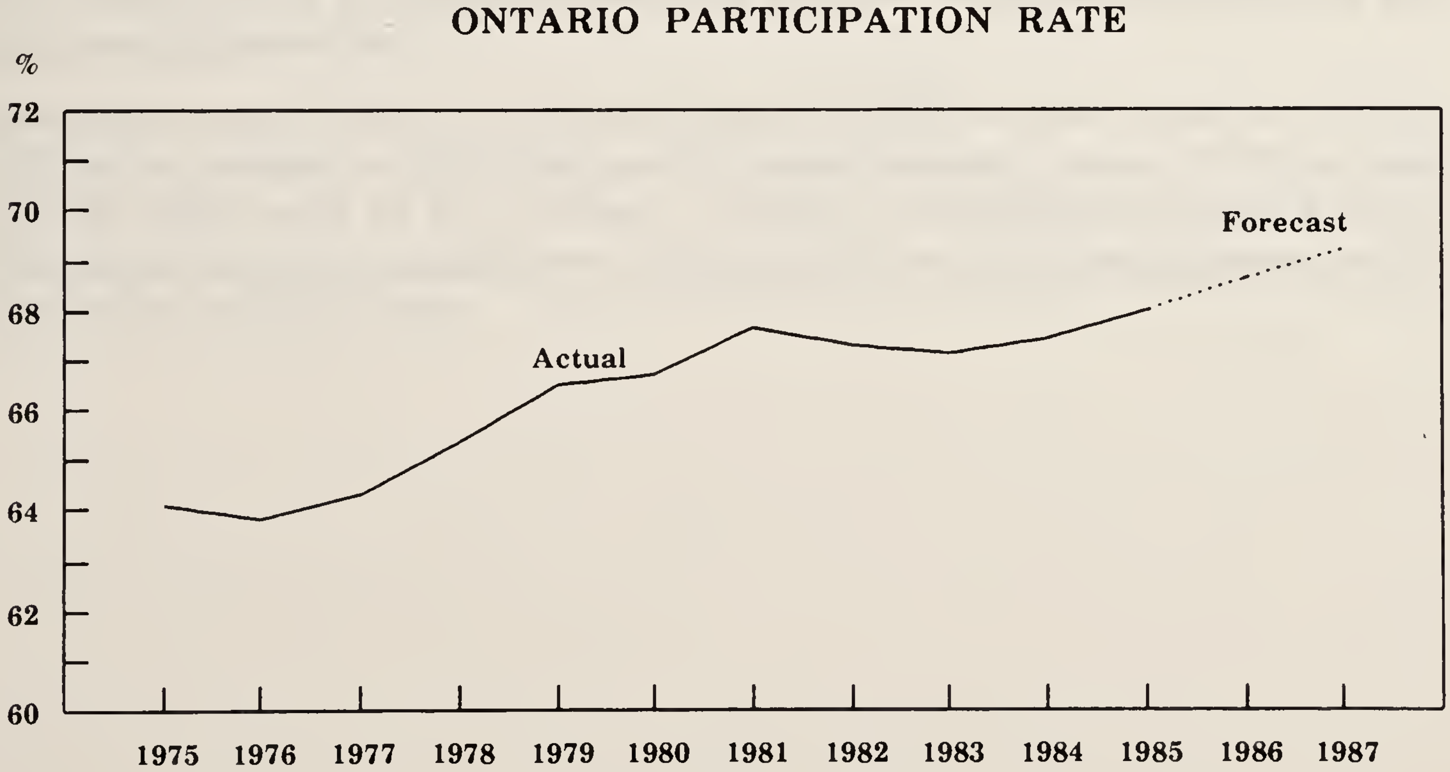
Labour Supply

Both population growth and participation rate increases will contribute to labour force growth. Ontario's labour force is expected to increase by 112,000, or 2.3 per cent, in 1986, and by a further 111,000, or 2.3 per cent, in 1987.

There will continue to be substantial growth in the 15 and over age group, the source population for the work force. This is due, in part, to interprovincial and international migration. Significant net inflows of people can be expected as a result of Ontario's strong economic performance relative to other provinces.

Ontario's labour force will also be affected by increases in the rate of participation in the labour force. In the short-run, participation rates are affected by labour market conditions. As labour markets deteriorate, participation rates fall. For example, participation rates decreased in 1982 and 1983 in response to rising unemployment. Conversely, rates tend to increase as labour markets tighten.

ONTARIO PARTICIPATION RATE



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

There is also a long-run trend of increasing labour force participation. The labour force participation rate in Ontario increased by 3.9 percentage points from 1975 to 1985. Two major factors have been the trend increase in women's participation rates and the changing age composition of the population.

- Women's participation rates have increased from 48.6 per cent in 1975 to 57.9 per cent in 1985. This growth is expected to continue, but at a decelerating rate.
- The 15 to 24 year old age group peaked in 1980, at 24.3 per cent of the source population. This share dropped to 21.7 per cent in 1985. Youth will continue to decline as a proportion of the source population, while the prime age group, 25 to 44 years of age, will increase. The prime age group has a higher participation rate than youth, and will continue to exert upward pressure on the aggregate participation rate.

Employment

Job creation is forecast at 156,000 this year, and a further 114,000 in 1987.

Job creation will continue to be concentrated in the service industries both this year and next. In the goods-producing industries, manufacturing and construction will remain significant contributors to employment growth. The private sector accounted for 140,000 or 88.1 per cent of the jobs created in 1985, and will continue to dominate job creation in 1986 and 1987.

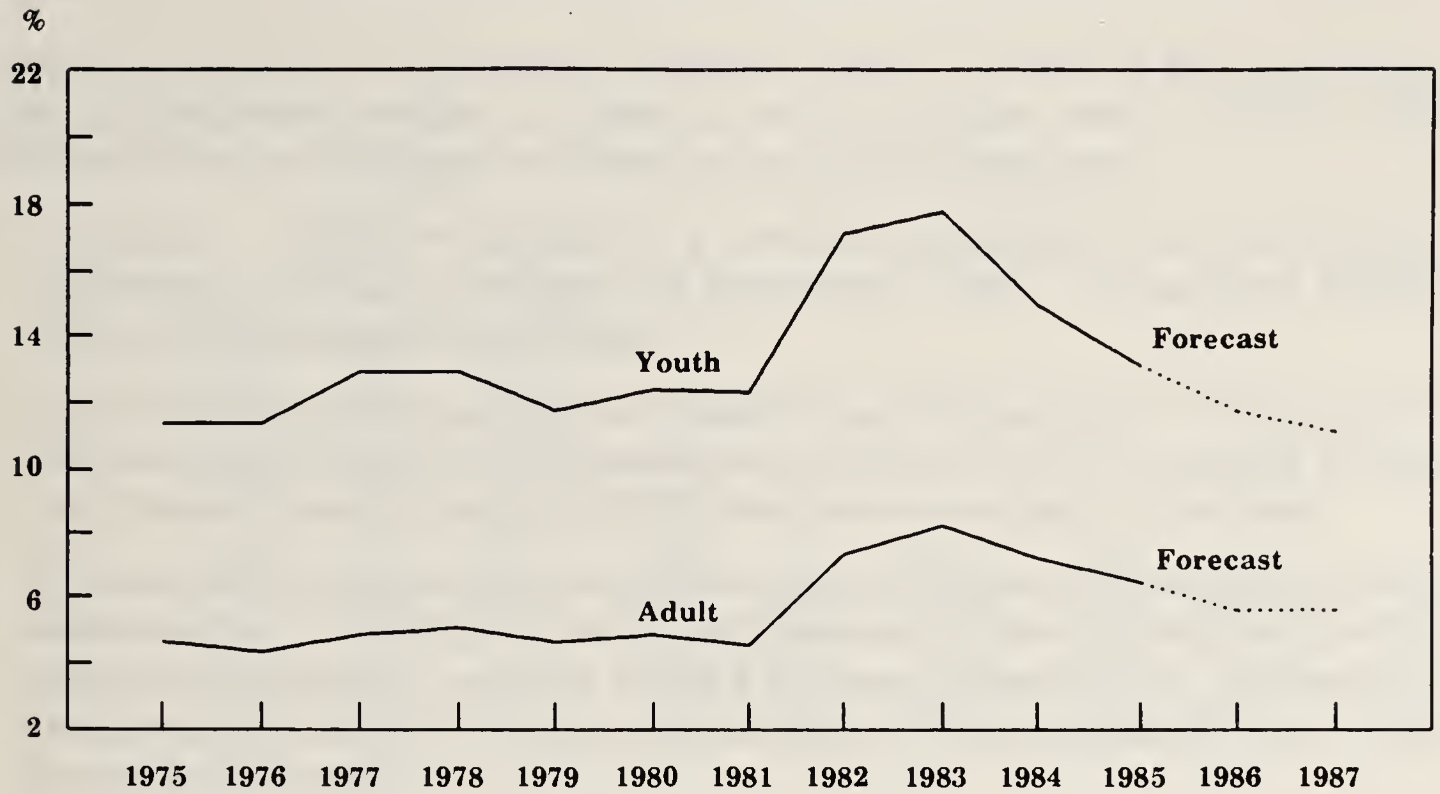
Most of the jobs created so far in 1986 have been full time. Indeed since the end of the recession, full-time employment has grown more strongly than part-time employment, in contrast to the experience of the late 1970s and early 1980s. Part-time employment in Ontario accounts for about 16 per cent of total employment. This is slightly higher than in the rest of Canada, but two percentage points lower than the comparable figure in the United States.

Unemployment

Employment growth is forecast to continue to outpace growth in the labour force, resulting in a decline in both the number of people unemployed and the unemployment rate.

Unemployment rates for youth continue to be higher than those for adults. Both rates peaked in 1983, the youth unemployment rate at 17.8 per cent and the adult rate at 8.1 per cent. Neither unemployment rate has yet returned to its pre-recession level, although the youth unemployment rate is expected to do so this year.

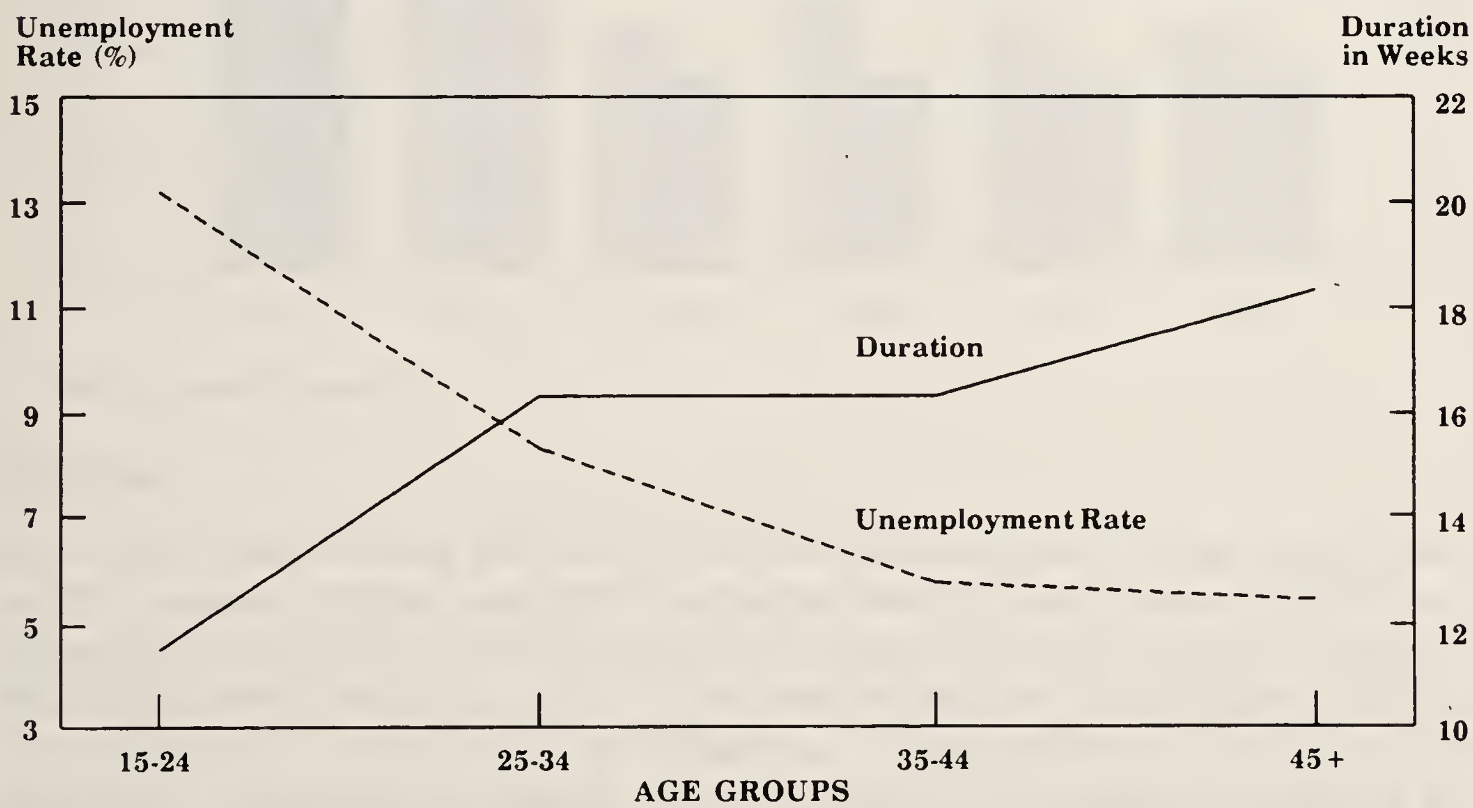
YOUTH AND ADULT UNEMPLOYMENT RATES



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

While youth have relatively high rates of unemployment, the incidence of long-term unemployment is lower for young people than for other age groups. Older workers, while typically having the lowest unemployment rates, are more likely to experience longer-term unemployment once they lose their jobs. In 1985, the duration of unemployment among older workers averaged 18.3 weeks compared to 11.5 weeks for youth.

ONTARIO UNEMPLOYMENT RATES AND AVERAGE DURATION OF UNEMPLOYMENT, 1985



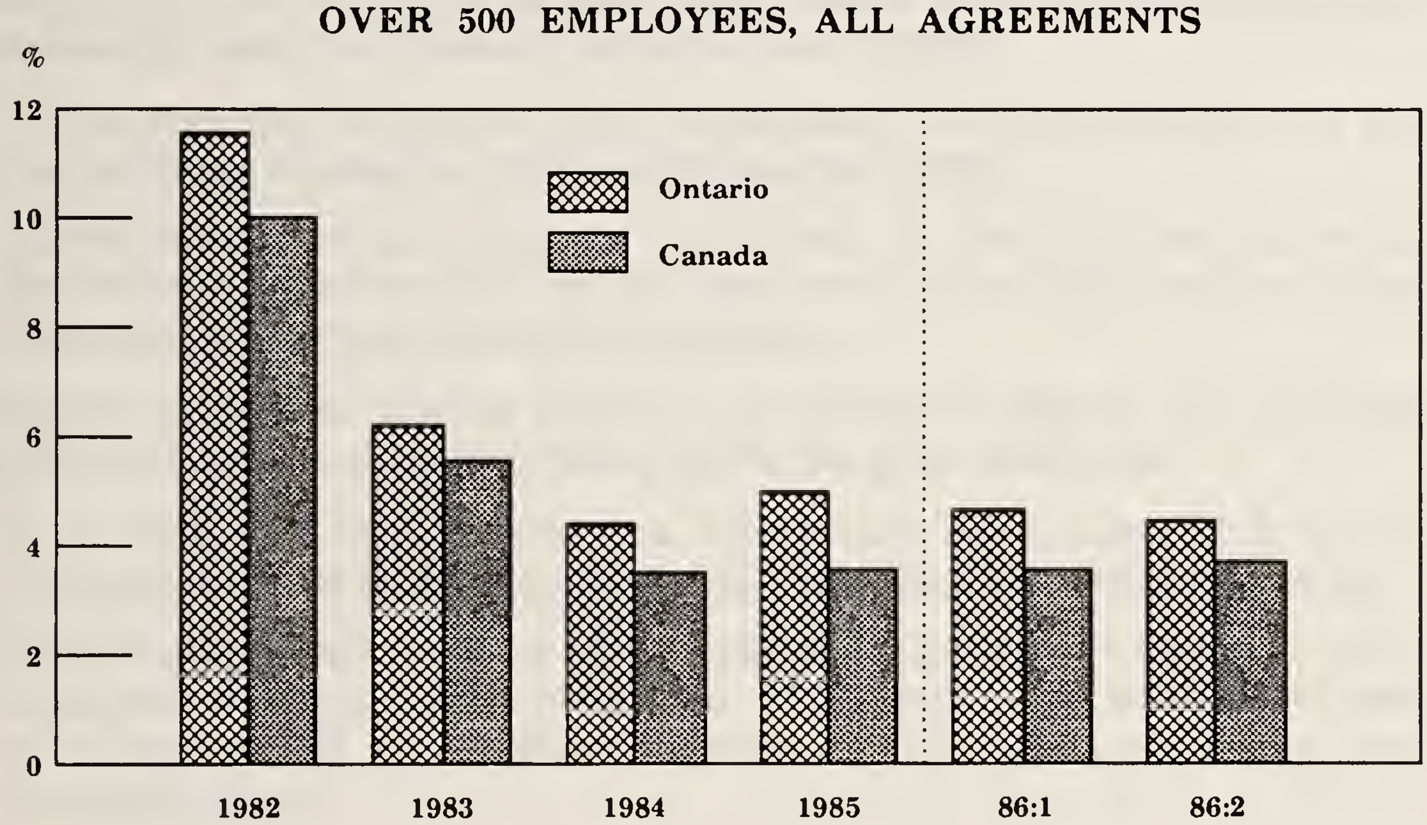
Source: Statistics Canada.

Wages

Wage increases have remained moderate since the end of the recession. Average industrial wages in Ontario rose by 4.6 per cent in 1985. This translated into an average real wage increase of 0.6 per cent.

- In Ontario, collective bargaining settlements without cost-of-living-adjustment (COLA) averaged 5.0 per cent in 1985. In the first half of 1986, they averaged 4.5 per cent.
- Data for the country as a whole indicate somewhat lower wage gains in the rest of the country. 1985 settlements without COLA averaged 3.6 per cent across Canada. So far in 1986, they are averaging 3.7 per cent.
- Private sector wage settlements have generally been below public sector settlements. In 1985, Canadian settlements in the private and public sectors averaged 3.1 per cent and 3.8 per cent, respectively. In Ontario, settlements averaged 4.3 per cent for the private sector and 5.1 per cent for the public sector.

NON - COLA WAGE SETTLEMENTS
OVER 500 EMPLOYEES, ALL AGREEMENTS

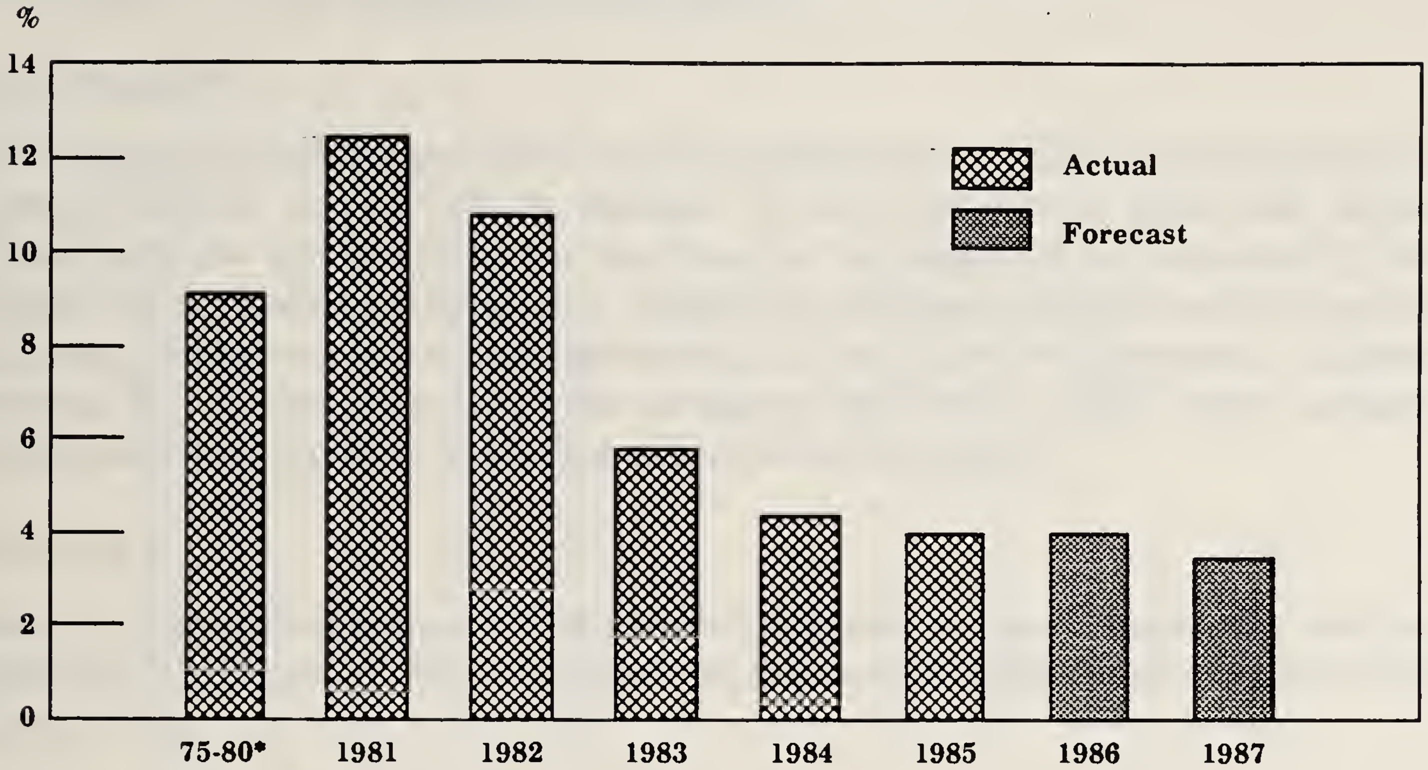


Source: Labour Canada.

Inflation

One of the more striking differences between the economy of the late 1970s and the economy of the mid-1980s is the markedly lower rates of inflation. Consumer price inflation fell from 12.5 per cent in 1981 to 4.0 per cent in 1985, the lowest rate since 1971. The recent decline in oil prices should consolidate the lower levels of inflation. Only moderate inflation is anticipated in the outlook period. The Consumer Price Index is expected to rise by 4.0 per cent in 1986 and by 3.5 per cent in 1987.

CONSUMER PRICE INFLATION



* Annual Average

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Falling oil prices, coupled with weak agricultural prices, have been placing downward pressure on Canada's inflation rate in 1986.

- The energy cost component of the Consumer Price Index fell by 12.1 per cent between September 1985 and September 1986.
- Agricultural product prices are also weak. In Ontario, farm prices of agricultural products fell by 2.9 per cent in the first half of 1986 compared to the same period a year earlier.

The main sources of upward pressure on Canada's inflation rate in 1986 have been increases in indirect taxes and in the price of services.

- It is estimated that federal tax hikes will have added 1.0 to 1.5 percentage points to the increase in the Consumer Price Index this year.
- Service prices have risen by an average of 5.0 per cent to date this year, compared to only 3.9 per cent in 1985. This acceleration has been driven to a large extent by the rapid increases in insurance premiums and housing prices.

In 1987, the inflationary impact of the increases in indirect taxes will have worked its way through the system. It is assumed that there will be no further increases in indirect taxes, aside from those already announced. Other factors will also contribute to low inflation.

- Raw materials will continue to face oversupply on world markets, exerting downward pressure on inflation. However, it is expected that there will be a modest firming of raw material prices from their current low levels.
- There is still sufficient excess capacity that continued economic expansion expected in 1987 can be accomplished without exerting upward pressure on prices.
- Prices of imported goods are expected to remain relatively stable.

Medium-Term Outlook: 1988-1990

Introduction

This section provides a projection of the performance of the Ontario economy beyond 1987 to the end of the decade. It is important to note that these projections are not targets; nor are they to be regarded as necessarily an acceptable economic performance. Moreover, unlike the short-term forecast, this is not a forecast of cyclical movements in output or employment. It is an attempt to indicate how large the economy will be by 1990, given certain reasonable assumptions about the external environment.

Overview

Ontario is projected to sustain its improved economic performance at least to the end of the decade. There are several key assumptions that underlie this expectation:

- Energy prices will increase only modestly.
- Real interest rates will continue to trend down.
- The Canadian dollar will not appreciate sharply relative to the U.S. dollar.
- The international economy will continue to expand, with a more balanced performance amongst the U.S., Europe and Japan.
- Significant increases in U.S. protectionism will be avoided.*

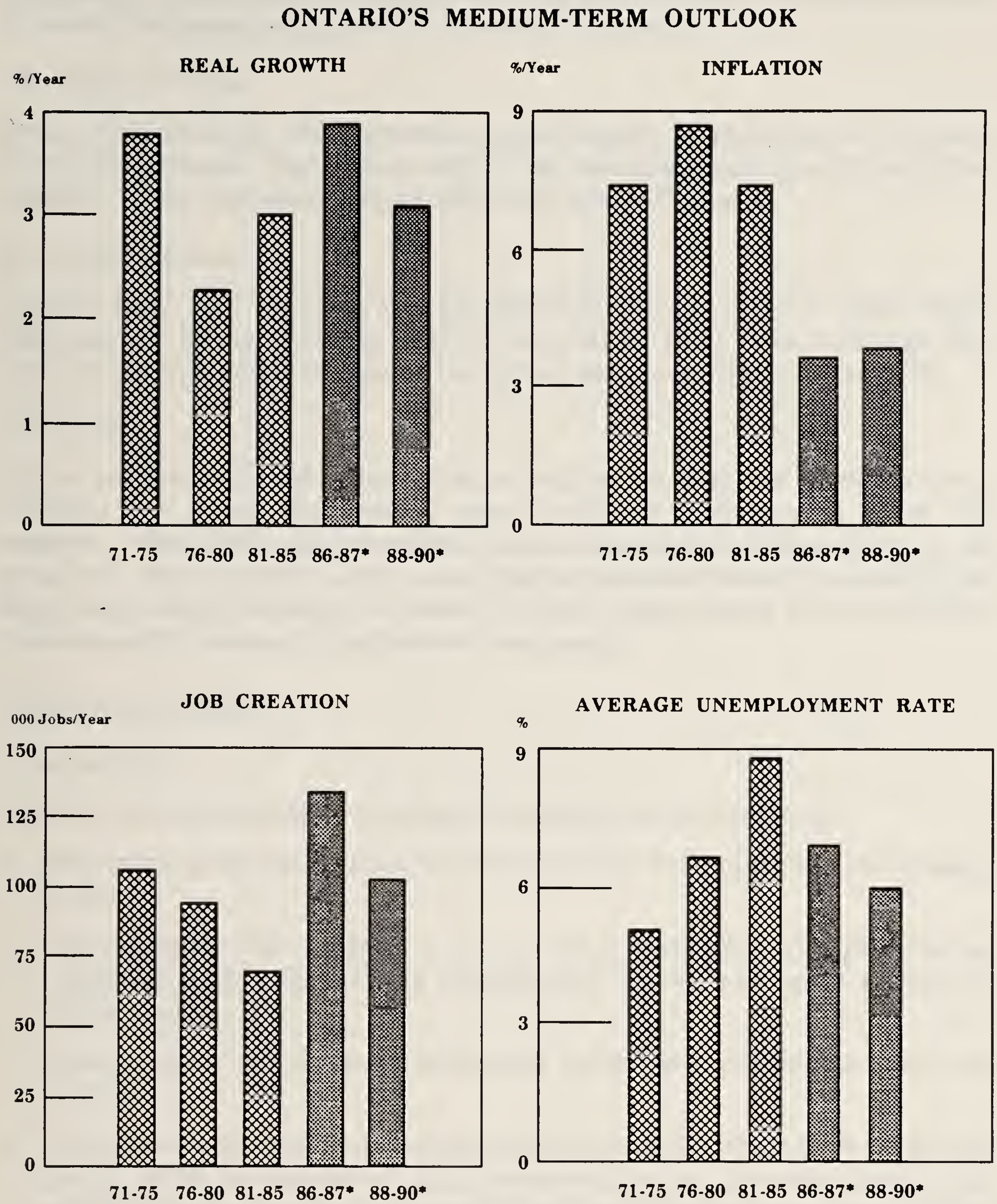
Table 4 summarizes the forecast for 1988-1990. The graphs that follow compare the forecast performance for the medium term with preceding periods. They indicate a significant improvement in the economic outlook relative to the past decade.

The Ontario Economy: 1988-1990 **Table 4**
(Annual Average)

	Base Case
Real Growth (%)	3.1
Inflation (%)	3.9
Job Creation (000s)	103
Unemployment Rate in1990 (%)	5.5

Source: Ontario Ministry of Treasury and Economics.

* A free trade agreement with the United States has not been assumed in the medium-term outlook.



* Forecast

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Key Factors in the Medium Term

The U.S. and World Economy

Over the remainder of the decade, 1988-90, the U.S. is projected to achieve moderate real growth averaging 3.0 per cent annually. U.S. budget deficit reduction is assumed to proceed in step with declining interest rates in the U.S. and continued low inflation. This results in steady growth of consumption and investment. The U.S. trade position is expected to improve

gradually, further supporting growth. This will be partly the result of better balanced and sustained growth in the world economy.

The Rest of Canada

From 1988 through 1990, growth across Canada is expected to be more evenly distributed. Moderate growth in the world economy should help firm resource prices and stimulate growth in the rest of Canada.

Financial Markets

Beyond 1987, real interest rates are assumed to trend down to historically more normal levels, reaching near 3.5 per cent by 1990. The exchange rate against the U.S. dollar is expected to appreciate gradually to 75¢ by 1990.

Oil Prices

Oil prices are expected to be stable in real terms over the medium term. Current low prices will induce some marginal producers to leave the market. They will also, over time, encourage more consumption of oil products. However, to a large extent, the increased efficiency in energy use that came about during the period of high energy prices is irreversible. Consequently, demand is unlikely to rise sharply.

Sources of Growth

Consumption

Medium-term prospects for consumer spending are very positive.

- Employment increases and real wage growth will raise real purchasing power.
- Savings rates will continue to decline from their present high level as inflation moderates and as uncertainty about economic prospects diminishes.
- Interest rates on consumer loans and mortgages will decline over the period.
- An increasing proportion of the population is in the 25 to 40 year-old age group, with its attendant high consumption of durable goods. In addition, the number of two-earner families will continue to rise. These demographic factors, in combination with the weak performance in the early 1980s, suggest the existence of strong potential demand.

Housing

Between 1988 and 1990, the formation of roughly 62,000 net new households per year can be expected. Also, there is some pent-up demand from the first half of the 1980s, when almost 70,000 new households were formed each year on average while housing starts averaged 49,500. In conjunction, these factors should result in expenditure on housing remaining strong. Given the favourable interest rate climate and a healthy

labour-market outlook, housing starts are expected to average between 71,000 and 75,000 per year.

Investment

The current rapid growth rates for investment spending are likely to moderate over the balance of the decade. After 1988, investment spending is expected to increase in tandem with the overall growth of the economy.

Investment will be supported by reasonably strong domestic demand, stronger corporate balance sheets reflecting the low inflation rate and further declines in interest rates, rising capacity utilization and further improvements in corporate profits.

Investment in machinery and equipment should continue to grow more rapidly than capital spending on non-residential construction.

Trade

Ontario's trade balance is expected to improve over the medium term. A sustained and balanced increase in the growth of the world economy, coupled with the maintenance of Ontario's competitive position, will continue to encourage export growth.

Imports during 1988-1990 will grow less rapidly than in 1986-1987. This results from more moderate growth in Ontario's economy. However, import growth will still remain substantial, reflecting the healthy growth in both consumer demand and business investment in machinery and equipment.

Employment, Productivity and Inflation

Employment and Labour Force

The Ontario economy is projected to generate 103,000 new jobs per year over the years 1988-90. Employment is expected to grow at an average annual rate of 2.2 per cent while the labour force is expected to grow at a 1.7 per cent average annual rate. The unemployment rate is forecast to drop to 5.5 per cent in 1990.

Growth of the labour force will slow over the forecast period. This reflects a marked slowdown in the growth of the over-15 population. This slowdown is only partially offset by an increasing participation rate. The age composition of the labour force will change over the forecast period. Despite increasing participation rates, the size of the youth labour force will be about 50,000 lower in 1990 than in 1985.

Productivity

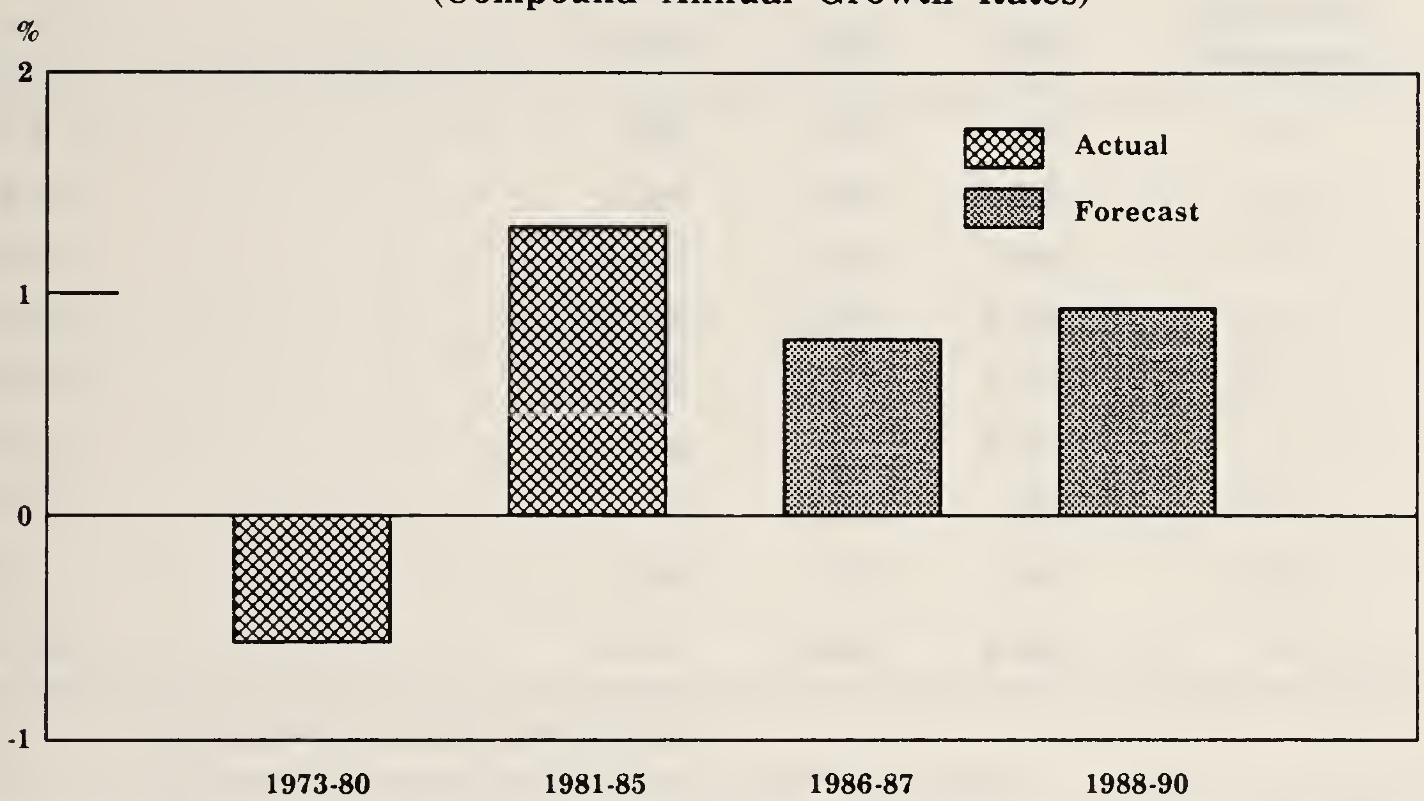
Productivity growth is a crucial factor in the economic outlook affecting international competitiveness, job creation and real income growth. Output per employee is projected to rise by 1.0 per cent per year over the forecast horizon. This would be a significantly better result than the provincial economy achieved in the 1970s, but is in line with more recent experience.

Between 1973 and 1980, output per employee in Ontario fell by 5.9 per cent. This decline reflected: energy price shocks, high inflation, low capacity utilization, slower capital formation, and rapid growth of the labour force.

These factors are not expected to be important in the outlook period. A better trend in productivity growth should be supported by:

- stable energy prices;
- low inflation;
- stronger capital formation in manufacturing and services;
- slower labour force growth; and
- maturing of the labour force .

ONTARIO PRODUCTIVITY PERFORMANCE
(Compound Annual Growth Rates)



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Inflation

Moderate inflation is expected to continue, with CPI increases averaging 3.9 per cent over the period 1988-90. Monetary policy in the major industrial countries, including Canada, is expected to be aimed at maintaining stable prices.

Population

In the 1988-1990 period, Ontario's population will grow by 1.1 per cent per year, compared to the 1.2 per cent per year that occurred in the period 1982 - 1985. The actual increase between 1987 and 1990 will be 304,000 people, with Ontario's population rising to 9,593,000. Around 60 per cent of expected growth will be due to the excess of births over deaths. Ontario is expected to experience continued population gains as a result of

interprovincial migration. In addition, Ontario will benefit from a moderate increase in net international migration.

The only age group to experience a decline in the 1988-1990 period will be young adults aged 15-24, whose numbers will decline by 7.3 per cent. The elderly population will grow by 105,000 or 10.1 per cent, with almost half this growth among those 75 and over. By 1990, the 65 and over age group will account for 12.0 per cent of Ontario's population compared to 10.7 per cent in 1985.

Ontario Population By Age Group: 1985, 1987 and 1990 **Table 5**
(Thousands)

	Population			
	1985	1987	1990	1990/1987 (% change)
0-4	626	651	666	2.3
5-14	1,258	1,248	1,272	1.9
15-24	1,553	1,508	1,398	-7.3
25-39	2,258	2,345	2,459	4.9
40-49	1,047	1,137	1,278	12.4
50-64	1,348	1,358	1,373	1.1
65-74	584	626	680	8.6
75+	386	416	467	12.3
TOTAL	9,060	9,289	9,593	3.3

Source: Ontario Ministry of Treasury and Economics.
Note: Data for 1985 are estimates and data for 1987 and 1990 are forecasts.

Sector Outlook

Overview

For the past five years, Ontario's growth in output has been based primarily on improvements in the auto and service sectors. For the next five years, Ontario's performance will be stronger and will reflect more balanced growth as other sectors are expected to show higher growth rates than earlier. Growth will be led by the construction industry, especially in 1986 and 1987, reflecting strong increases in residential construction. Above average growth will also continue to be experienced by the transportation equipment industry. The primary sector and resource-based industries, while improving on their 1981-85 performance, will show the least growth; slow growth in world demand for their products will persist. In keeping with its past performance, the service sector will be a source of higher than average growth over the forecast period.

Sector Outlook for Ontario **Table 6**

	Real Output (Annual % Change)	
	1981-85	1986-90
Primary	0.2	1.6
Manufacturing	2.4	3.1
Resource-Based Manufacturing	0.8	2.4
Transportation Equipment	10.2	3.6
Other Manufacturing	1.4	3.3
Construction and Utilities	2.7	4.2
Service Sector	3.3	3.6
Total	2.9	3.4

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.
Note: Industries included in each sector are enumerated in sections below.

Unit Labour Costs

The strength of Ontario's economic outlook, including continued growth in exports, in part reflects improvements in Ontario's competitive position in the U.S. market. A significant factor has been the decline in Canada's unit labour costs, measured in U.S. dollars, relative to those in the United States.

In the late 1970s and early 1980s strong resource prices led to rapid domestic inflation, increased strike activity and high wage settlements relative to the United States. This was partially offset by currency depreciation. In turn, since 1982 the weaker resource sector has moderated domestic inflation and wage settlements throughout the economy. Lower

resource prices have also weakened the Canadian dollar, further adding to the improved relative cost performances in Canada.

Between 1981 and 1985, unit labour costs rose by 12.4 per cent in the U.S. and 19.8 per cent in Canada.

However, when exchange rate movements are taken into account, unit labour costs in Canada -- measured in U.S. dollars -- increased by only 5.2 per cent over the same period. During 1984 and 1985, exchange rate adjusted Canadian unit labour costs declined by a total of 5.2 per cent, primarily resulting from a depreciation of nearly 10 per cent in the Canadian dollar.

Canada-U.S. Unit Labour Costs, 1981-1985 **Table 7**
(Per Cent Change from Previous Year)

	1981	1982	1983	1984	1985
United States	8.7	7.0	0.5	1.2	3.4
Canada	12.5	11.9	1.9	2.4	2.6
Canada*	9.7	8.7	2.0	-2.6	-2.7

Source: Bank of Canada and U.S. Department of Labor.
* Exchange rate adjusted to express Canadian costs in terms of U.S. dollars.

- The substantial depreciation of the Canadian dollar against major European currencies and the Japanese yen since the G-5 agreement in September 1985 should make Ontario's exports more competitive, not only in Japan and Western Europe, but also in the important U.S. market.

The forecast anticipates no significant change in relative unit labour costs over the forecast horizon.

Business Investment

An indication of the combined effects of stronger demand and increased competitiveness is provided in this year's investment intentions of business in Ontario.

- Investment in manufacturing will account for about two-thirds of the expansion in total business investment in 1986. Substantial increases in investment are expected in the transportation equipment industries, essentially autos, followed by the metal fabricating and machinery industries.

- Investment in commercial services and in the retail and wholesale trade sector will be quite robust. A healthy expansion is also expected in both the finance and construction sectors.

- Investment is expected to be much stronger for machinery and equipment than for non-residential construction, due to business use of new technology to improve productivity.

Share of Ontario Non-Residential Business Investment **Table 8**

	1985	1986
	(per cent)	
Agriculture & Fishing	5.6	3.4
Forestry	0.2	0.2
Mining, Quarrying & Oil Wells	3.2	2.5
Manufacturing	29.0	33.8
Construction	2.2	2.2
Utilities	27.4	24.7
Trade	4.9	5.0
Finance, Insurance & Real Estate	13.2	13.1
Commercial Services	14.3	15.1
Total Business Investment	**100.0**	**100.0**

Source: Statistics Canada.

Primary Sector Outlook

Following modest increases in real output in 1985, agriculture, mining and forestry are expected to show further gradual increases in the next five years.

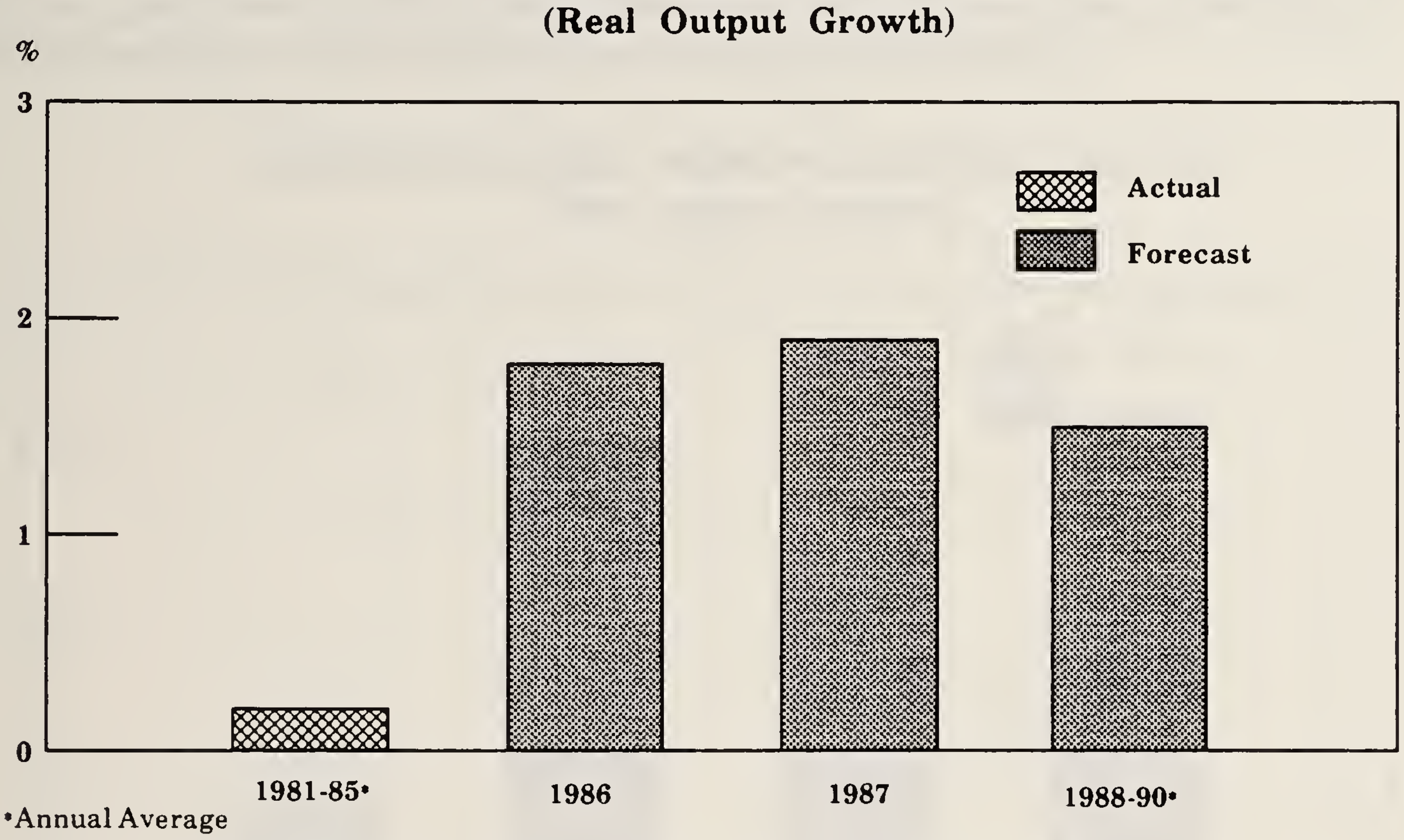
The outlook for Ontario's relatively diversified agricultural sector is for real output growth of about 1.5 per cent annually. Prospects for red meat, especially hogs, are relatively favourable due to higher prices and lower feed costs. Output of fruit, vegetable and nursery production, and supply-managed products such as dairy and poultry should remain relatively stable, with poultry continuing its steady growth. However, for corn, wheat and, to a lesser extent, soybeans, the impact of lower prices caused by the U.S. Food Security Act of 1985 will be significant. In the tobacco sector, further industry rationalization is expected. Farmers' difficulties in servicing debt will ease somewhat as a result of declining interest rates, government programs and, in many cases, lower levels of debt.

Within the mining sector, gold and platinum are the two brightest spots. The Hemlo area gold mines are still expanding. With the recent rise in gold and platinum prices, and increases in exploration activity, it is possible that a number of new mines will be developed. One zinc deposit is also under

development. However, iron ore mines will continue to face difficulties, reflecting the high operating costs of Ontario mines, and limited demand in downstream steel markets.

Forestry output is expected to improve steadily, reflecting strength in the downstream wood products and pulp and paper industries. In addition, forest management agreements with the major operators are leading to expansion of nurseries and forest regeneration activities.

PRIMARY SECTOR OUTLOOK
(Real Output Growth)



•Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Manufacturing Outlook

Resource-Based Manufacturers

Resource-based manufacturers include pulp and paper, wood products, primary and non-metallic metals, metal fabricating and petroleum refining. The success of most of these industries is closely related to world market conditions. The outlook assumes that moderate growth in the United States and OECD will continue; it also assumes that exports to the important U.S. market will not be significantly curbed or restrained by new protectionist efforts.*

Following very slow growth over the past five years, output is expected to increase significantly between 1986 and 1990. Nonetheless, growth rates will still be below the average for manufacturing or for the economy as a whole.

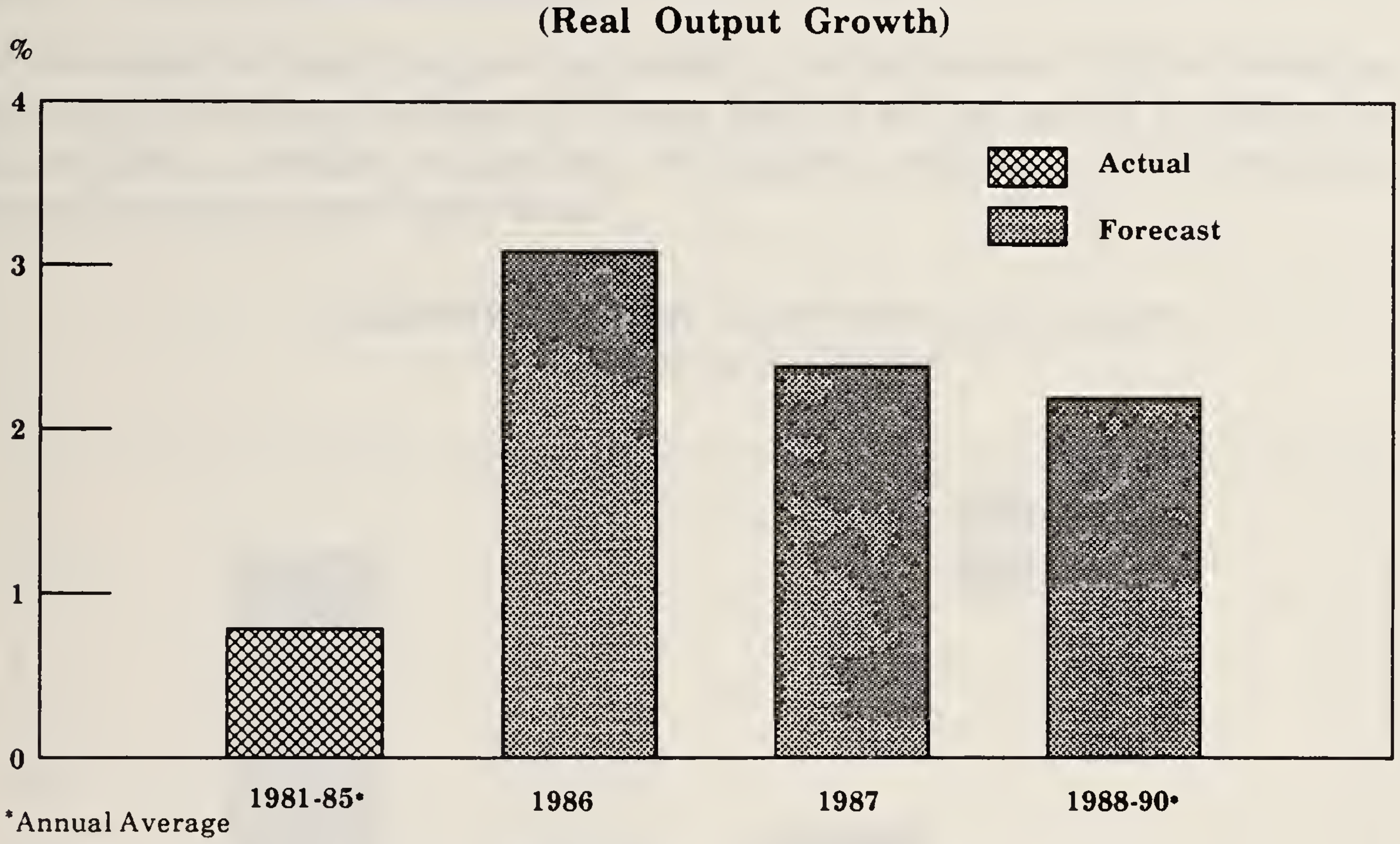
Demand and prices for pulp and paper are increasing again and Scandinavian producers are less competitive in the U.S. market as a result of recent currency adjustments. In addition, the high level of residential

* This forecast is based on a positive resolution of the softwood lumber dispute.

construction activity in Canada and the United States is giving strong impetus to production and exports of lumber. Non-metallic mineral products and fabricated metals, although more oriented to domestic markets, are also benefitting from the pace of construction activity.

While steel producers are completing extensive modernizations, resulting in one of the most efficient industries in the world, very little growth in production is expected during the next five years. Expected increases in demand from the automotive sector are being offset by sharply lower sales to the energy industry, and by restrained exports to the United States. In addition, petroleum refining will experience negligible output growth due to continuing gains in fuel economy in the transportation sector.

RESOURCE-BASED MANUFACTURERS OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Transportation Equipment

In 1986, real output in Ontario's transportation equipment sector is expected to increase by 4.5 per cent. For 1987, with new production from Honda and AMC coming on stream, real output is anticipated to increase by 5.0 per cent. For the 1988-90 period, continued real growth of 2.9 per cent per year is forecast, buoyed by new investment by both U.S. and Japanese auto companies.

Ontario's transportation equipment sector is dominated by motor vehicles and parts, which account for about 95 per cent of the sector's value of shipments and 85 per cent of its employment. Ontario has benefitted from the automobile industry's drive to become more competitive due to the province's advantageous location and its efficient and cost-effective labour force. North American producers' investments include: Chrysler's mini-van plant in Windsor; AMC's new $764 million assembly plant in Brampton; and GM's $2 billion GM-10 project in Oshawa. In addition, in an attempt to

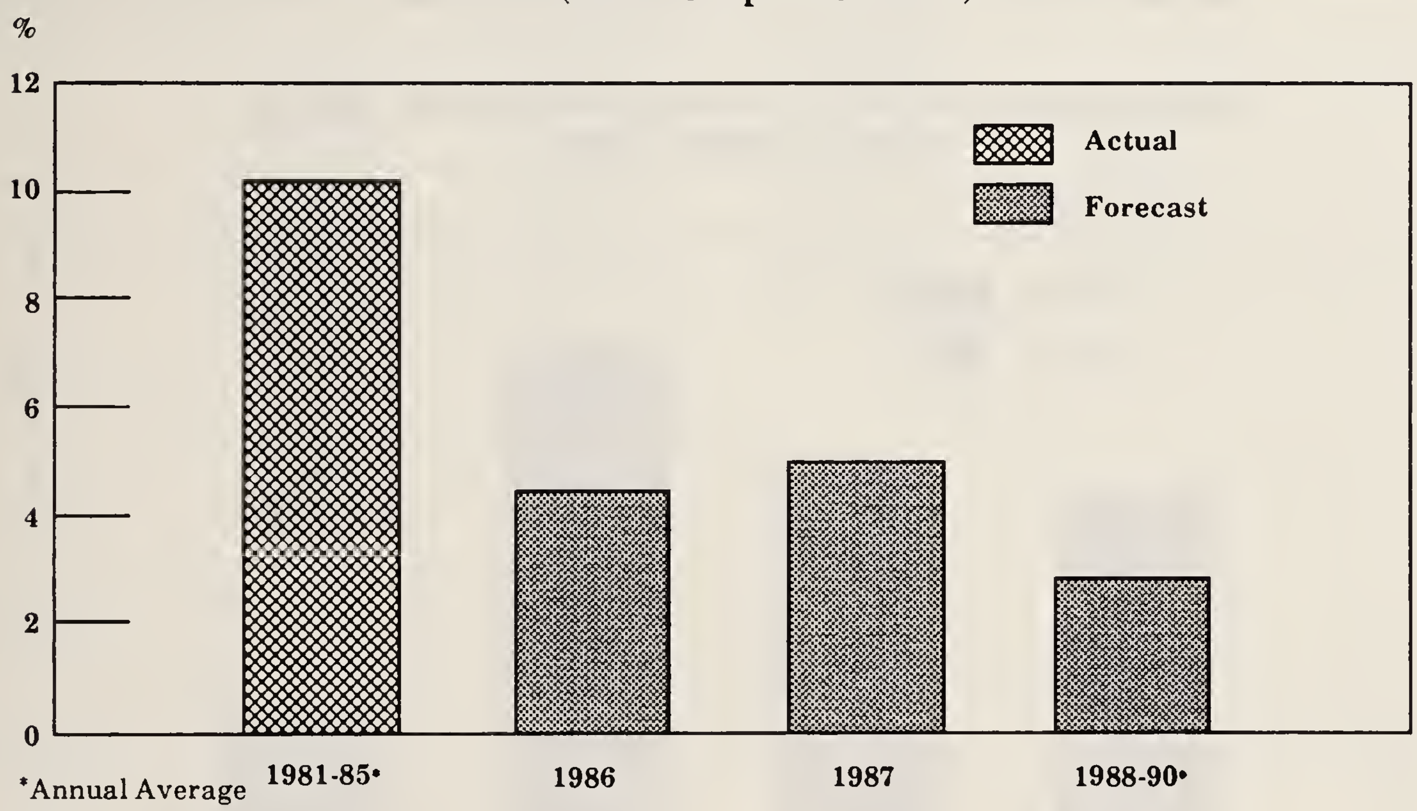
anchor their export markets, Japanese auto makers are making substantial investments in assembly plants in Ontario: Honda, $200 million; Toyota, $400 million; and Suzuki in partnership with GM, $500 million.

This year, sales of North American cars and trucks are expected to level off, following large increases in 1984 and 1985. However, demand for the larger cars, trucks and mini-vans, in which Ontario's production is concentrated, should continue to expand. Sales of these vehicles will benefit from low gasoline prices and more lenient fuel economy standards in the U.S.

The auto parts sector is expected to grow but at a slower rate than the assembly sector. In part, this is due to increased foreign offshore producer penetration of the U.S. market and a growing trend in the U.S. domestic industry to source parts to newly-industrializing countries such as Brazil, Mexico, Taiwan, and South Korea.

The aerospace industry is growing steadily. In particular, DeHavilland has announced orders and options on 82 new Dash-8 aircraft worth an estimated $730 million. Further orders are anticipated, reflecting the increase in demand for commuter air services.

TRANSPORTATION EQUIPMENT OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Other Manufacturing

Healthy growth is expected in electronics and, to a lesser extent, in electrical products. This will be fuelled by strong business spending, especially in the service sector, and continued strong residential construction and consumer spending on appliances. Machinery sales will be aided by growth in business investment in plant and equipment. Export opportunities in offshore markets will also improve, particularly since

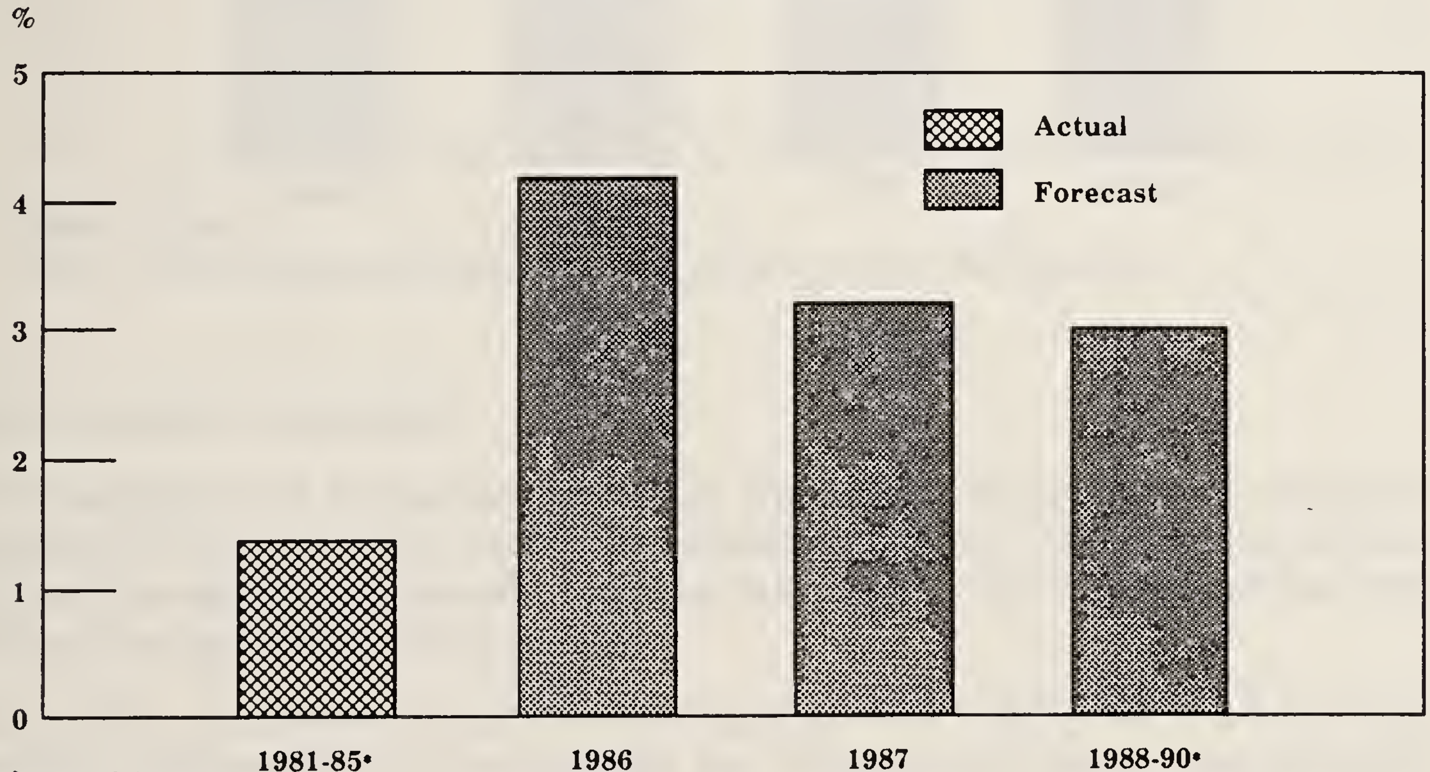
European and Japanese competitors' prices have risen due to currency changes.

Cautious optimism about chemical production is based on lower feedstock prices and industry-wide restructuring, rationalization and productivity improvements in response to world-wide over capacity. Pharmaceuticals, cosmetics, soaps, detergents and specialty chemicals are expected to do well, as are paint manufacturers supplying the construction industry. The plastics industry is expected to gain further market share from more traditional materials such as metals and glass.

The printing and publishing industries will continue to be strong performers. In addition, the furniture and textile industry will be buoyed by the rapid growth in housing construction and renovation. The clothing industry is also demonstrating strength as Canadian design talent becomes better recognized.

The food and beverages industries are expected to show only marginal growth, despite efforts by the industry to introduce new products and adopt newer packaging techniques. The leather products industry is adjusting to the removal of quotas on men's and boys' shoes, and to the relaxation of quotas on women's and girls' shoes. Progressive firms in the industry show prospects of growth in markets for higher priced, high fashion shoes.

OTHER MANUFACTURING INDUSTRIES OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

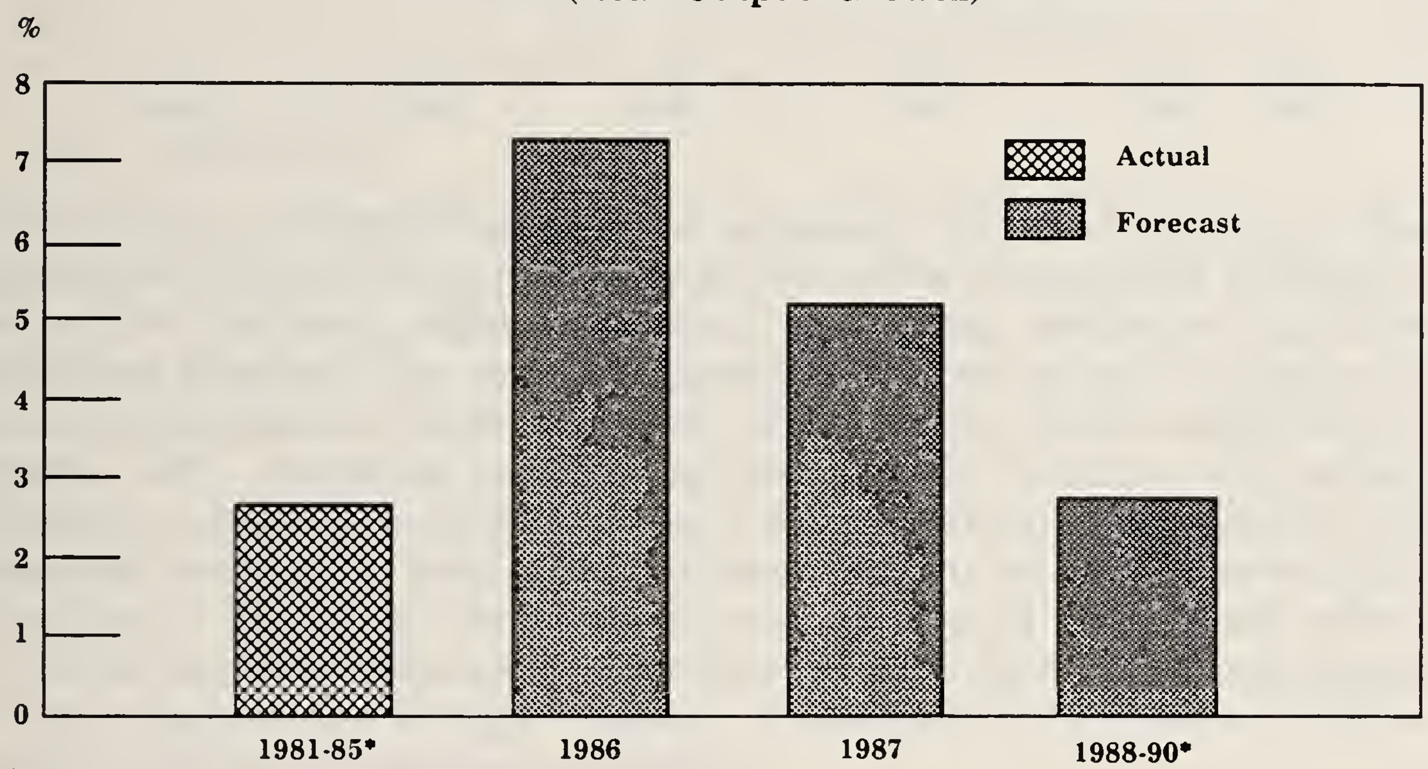
Construction and Utilities Outlook

The construction sector is expected to lead output growth, expanding by 9.5 per cent in 1986 and 6.4 per cent in 1987. In the 1988-90 period, growth is expected to match the overall rate of growth of the economy. This sector is buoyed by the surge in activity in residential construction and by the continued moderate expansion in plant construction. Ontario's housing

starts are expected to climb to 73,000 in 1986, and 77,000 in 1987. Renovations are expected to contribute significantly to the increase in residential construction activity. Non-residential construction is expected to show steady improvement. Most of the strength is attributed to construction projects in the manufacturing sector, primarily the expansion of automobile manufacturing facilities.

The utilities sector includes Ontario Hydro, local electrical utilities, natural gas distributors and water distribution utilities. For 1986 and 1987, output in the utilities sector is forecast to grow in real terms at 4.0 per cent and 3.3 per cent, respectively. In 1988-90 growth will slow to 2.3 per cent annually.

CONSTRUCTION AND UTILITIES OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

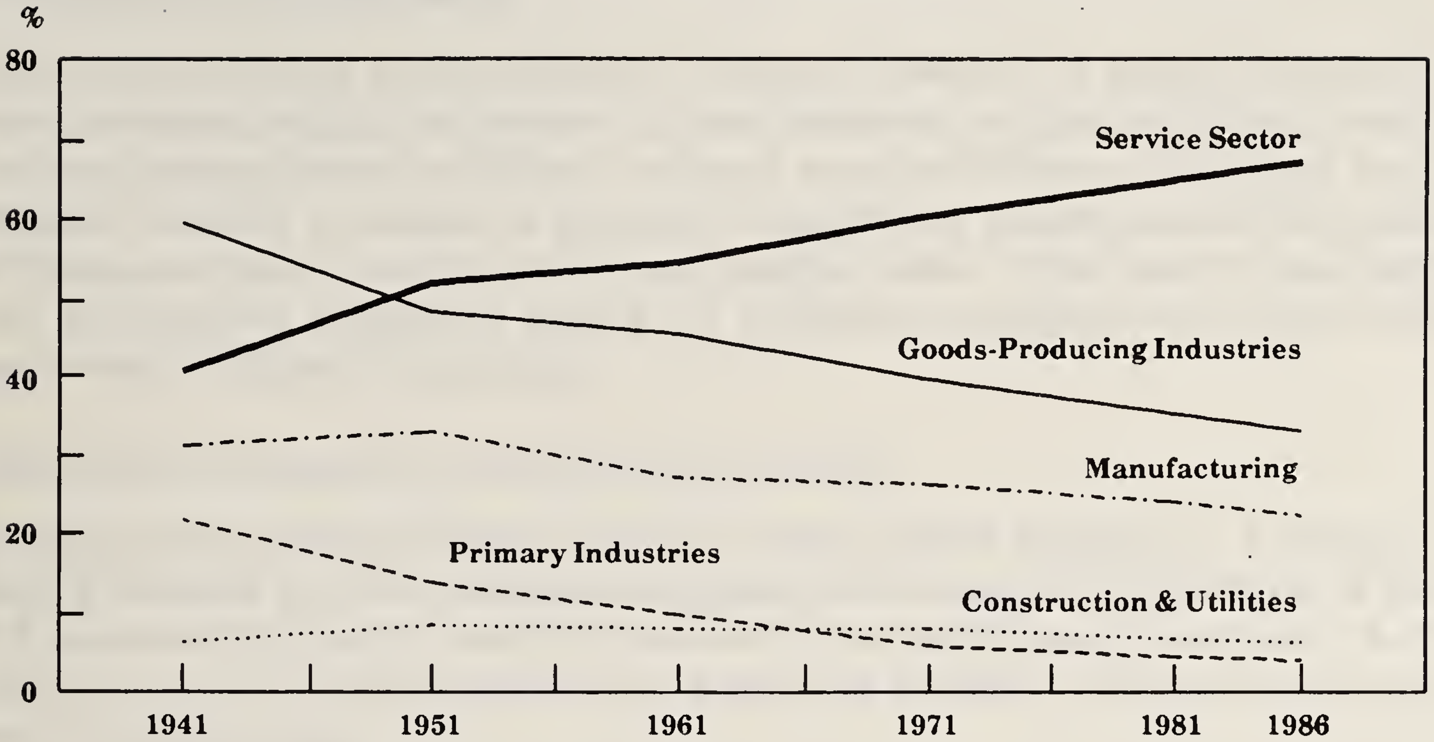
Service Sector Outlook*

The emergence of the service sector as the largest component of Ontario's economy is not a recent or sudden phenomenon. Since 1951, employment in the service sector has exceeded that in the goods-producing industries, and the gap has been increasing rapidly.

Since 1971, the service sector has averaged a real growth rate of 3.5 per cent per year, compared to 3.0 per cent for the economy as a whole. Employment growth in services has been equally impressive. The service sector also shows less cyclical variability in output. Even during the 1982 recession, when other sectors experienced varying degrees of setback, services managed 0.2 per cent growth in output.

* For a more detailed analysis of this sector, see Background Notes on the Service Sector in Ontario, Ministry of Treasury and Economics, May 1986. A final report by Mr. George Radwanski is forthcoming.

SHARE OF ONTARIO EMPLOYMENT BY SECTOR

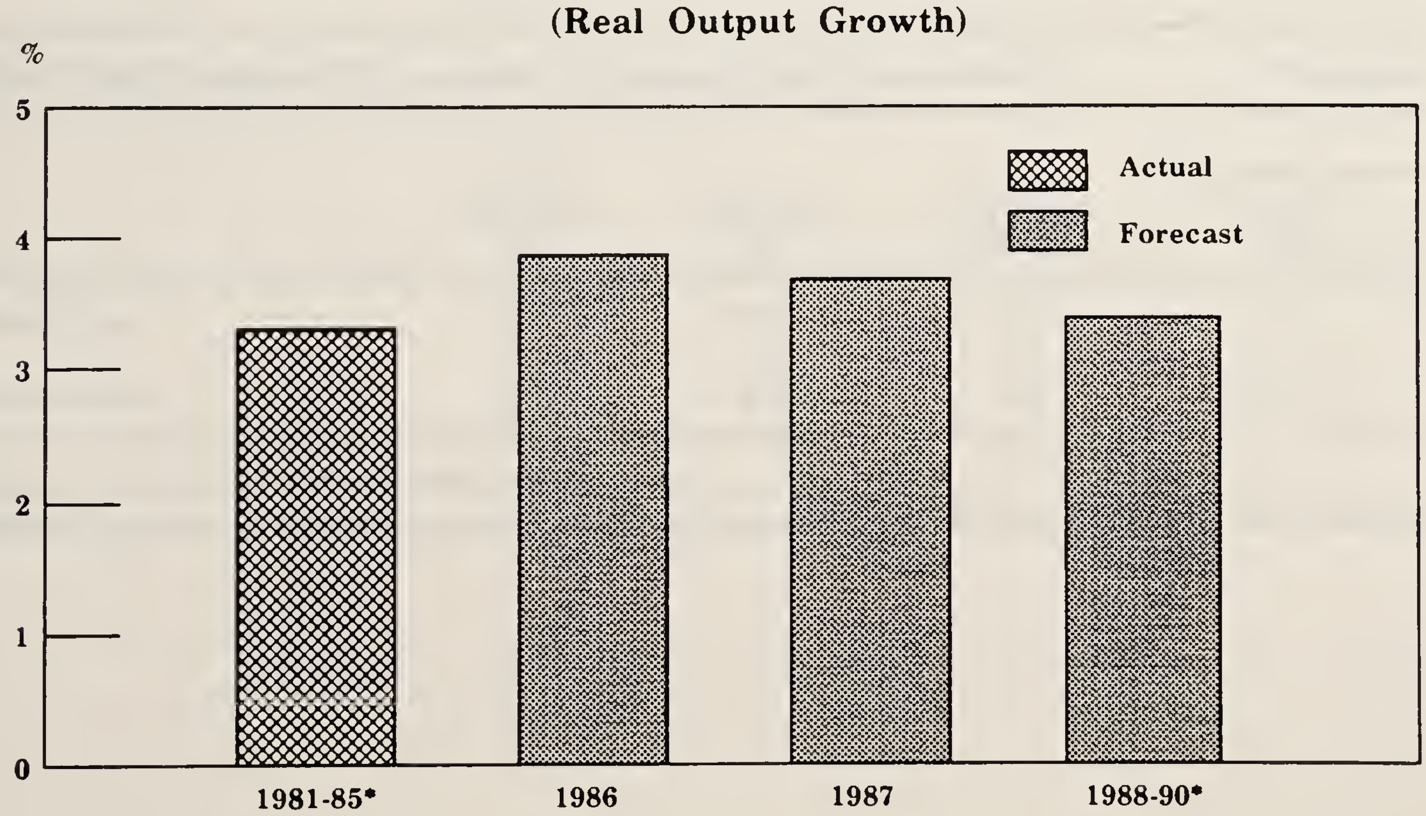


Source: Statistics Canada.

Several factors are contributing to the expansion of the service sector. The information age and the growing complexity of the economy are increasing the need for financial, legal, accounting, advertising, computer and other specialized services. The strongest growth is in these areas. The aging of Ontario's population is increasing demand for services related to health and personal care. Increased personal incomes and the growth of two-earner families are leading to greater demand for recreational, educational and household services. In particular, tourism will be an important beneficiary of the steady growth in household incomes. Increased promotional efforts and the favourable exchange rate will also enhance Ontario's attractiveness to both domestic and foreign tourists. An estimated $8.2 billion will be spent in 1986 by all travellers in Ontario.

Real output in the service sector is expected to grow somewhat more rapidly than in the goods-producing sector throughout the forecast period. Services will continue to be Ontario's major source of employment growth.

SERVICE SECTOR OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Alternative Scenarios

All forecasts depend on assumptions. Because Ontario's is a relatively small open economy, highly vulnerable to developments in the rest of the world, the key assumptions for Ontario concern external factors. The base case, outlined earlier, presumes a generally supportive international economic environment and a reduction in real interest rates. This section develops two alternative scenarios based on different assumptions about the performance of the U.S. economy.

Alternative Scenario I: Lower U.S. Growth

In this lower growth scenario, the U.S. trade deficit worsens as a result of falling demand for U.S. industrial exports and increased penetration of the U.S. market by imports, notably from newly-industrializing countries. As a result, real U.S. growth declines to 0.3 per cent in 1987 (compared to 2.9 per cent in the base case).

Lower growth would also lead to a larger than expected federal budget deficit. Current concern over the size of the U.S. budget deficit suggests it would be unlikely for fiscal stimulus to be used to offset the effects of a slowdown. In addition, a worsening federal budget deficit may limit the Federal Reserve Board's ability to reduce interest rates further, particularly if central banks in Germany and Japan refuse to parallel cuts in the Board's discount rate. Monetary policy could be restrained by the need to attract sufficient overseas capital to help finance both the current account deficit and the federal budget deficit.

- The impact of the trade deficit on growth would be compounded by further declines in business investment.
- Consumer spending, currently the major source of growth in the U.S. economy, would be reduced as a result of slower employment and income growth.

Table 9 summarizes the short-term impact of slower U.S. growth on Ontario's economic performance.

The 1987 Ontario Economy: Alternative Scenario I — **Table 9**

	Real Growth (%)	Inflation (%)	Job Creation (000s)	Unemployment Rate (%)
Base Case	3.6	3.5	114	6.7
Low Growth	1.5	3.3	65	7.8

Source: Ontario Ministry of Treasury and Economics.

- Initially, the impact of a stagnating U.S. economy would be felt in Ontario's export sectors such as autos, resource-based commodities, and certain capital goods oriented to U.S. markets. However, lower employment and income growth in the export sectors would ultimately weaken domestic demand.
- The slowdown in global demand would limit growth of markets for Ontario products and undermine business confidence, resulting in reduced business investment in Ontario.
- Profits would decline in 1987; sales volumes and margins would be hard-hit. Projects currently underway would likely be completed as firms attempted to assess the severity of the decline in demand. Projects now in the planning stage would be unlikely to come to fruition until growth has resumed and excess capacity has been absorbed.
- The housing sector would remain fairly buoyant over the short-term as pent-up demand and lower interest rates would continue to spur growth. However, weaker growth in personal income eventually would have a dampening effect on the demand for housing.

In this scenario it is assumed that the United States does not adopt new protectionist measures. However, the impact would be exacerbated by aggressive U.S. protectionism in reaction to a further deterioration in the U.S. trade deficit.

Over the medium-term horizon, while the U.S. economy would be expected to rebound toward the latter half of 1988, growth would be lower than assumed in the base case. The U.S. economy would average 2.5 per cent growth during the 1988-1990 period, as opposed to 3.0 per cent in the base case.

Slower growth in the U.S. would, in turn, induce slower growth in the Ontario economy over the medium term. Real growth in Ontario would average 2.2 per cent annually between 1988-1990, down from 3.1 per cent in the base case.

- Slower U.S. growth would directly reduce export growth which in turn will have an adverse multiplier effect on consumption.
- Business investment would also be adversely affected as a result of both weaker domestic demand and exports.

The 1988-1990 Ontario Economy: Alternative Scenario I **Table 10**

	Average Real Growth (%)	Average Inflation Rate (%)	Average Job Creation (000s)	1990 Unemployment Rate (%)
Base Case	3.1	3.9	103	5.5
Low Growth	2.2	3.8	87	6.6

Source: Ontario Ministry of Treasury and Economics.

Alternative Scenario II: Higher U.S. Growth

In this scenario, improved international co-ordination of economic policy, with the objective of generating more rapid and better balanced growth, is assumed to lead to a stronger world economy. The U.S. trade deficit declines significantly, as Japan and Western Europe adopt more stimulative economic policies. Growth in the U.S. would rise to 3.7 per cent in 1987 from 2.9 per cent in the base case.

- Faster growth would help bring down the U.S. budgetary deficit, reducing the pressure for fiscal restraint.
- A stronger U.S. economy would buy more of the goods and services produced in the rest of the world, including Ontario.

Table 11 shows the short-term effects on the Ontario economy of more rapid American growth.

The Ontario Economy in 1987: Alternative Scenario II — Table 11

	Real Growth (%)	Inflation (%)	Job Creation (000s)	Unemployment Rate (%)
Base Case	3.6	3.5	114	6.7
High Growth	4.5	4.0	127	6.6

Source: Ontario Ministry of Treasury and Economics.

- Faster growth in Ontario would bring the unemployment rate down more rapidly.
- Consumer spending would be stimulated by falling unemployment, stronger income growth and the boost to consumer confidence resulting from a healthier world economy.
- Ontario industries benefitting most directly and immediately from a stronger U.S. and world economy would include transportation equipment, mining and metals, forest products, machinery and electrical products. To a lesser extent, industries oriented to consumer goods and services would also benefit.

Over the medium term, 1988-1990, the U.S. economy would be expected to grow at an average annual rate of 3.8 per cent. Stronger U.S. growth would facilitate a more rapid decline in the U.S. federal deficit, in turn permitting the Federal Reserve Board to loosen monetary policy. This would result in lower interest rates than assumed in the base case.

As in the short-run, Ontario would reap significant benefits. Real annual growth in Ontario would average 3.6 per cent, 0.5 percentage points higher than in the base case.

- Initially, exports would be stimulated the most. Subsequently, consumption would be stimulated by stronger income growth and

investment would be enhanced by increased domestic and foreign demand.

- Canadian interest rates would fall in line with U.S. rates and provide further stimulus to both the consumer and business sectors.
- The unemployment rate would drop to 5.2 per cent by 1990, as compared to 5.5 per cent in the base case. The additional decline in the unemployment rate due to higher growth would be moderated to some extent by more rapid labour force growth.
- Inflation would be somewhat higher, averaging 4.5 per cent between 1988-1990, 0.6 percentage points higher than in the base case. This reflects the impact of the stronger domestic and international economic environment on commodity prices and wages.

The 1988-1990 Ontario Economy: Alternative Scenario II — Table 12

	Average Real Growth (%)	Average Inflation (%)	Average Job Creation (000s)	1990 Unemployment Rate (%)
Base Case	3.1	3.9	103	5.5
High Growth	3.6	4.5	111	5.2

Source: Ontario Ministry of Treasury and Economics.

The following table consolidates the scenarios for the Ontario economic outlook for both the short and medium term.

Summary of Scenarios — Table 13

	Real Growth (%)	Inflation (%)	Job Creation (000s)	Unemployment Rate (%)
1985 Actual	4.7	4.0	159	8.0
1986 Forecast	4.1	4.0	156	7.0
1987				
Base Case	3.6	3.5	114	6.7
Alternative Scenario I	1.5	3.3	65	7.8
Alternative Scenario II	4.5	4.0	127	6.6
1988-90*				
Base Case	3.1	3.9	103	5.5
Alternative Scenario I	2.2	3.8	87	6.6
Alternative Scenario II	3.6	4.5	111	5.2

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

* Annual averages, except for the unemployment rate which is for 1990.